In June 2001, Congress and the president approved the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA), the largest tax cut in two decades. The multiyear cut, scheduled to phase in gradually over the decade, will reduce taxes (and government revenue) by $1.35 trillion by 2010. EGTRRA then “sunsets” on December 31, 2010, restoring the law to its pre-2001 status. This unusual sunset provision, considered a budget gimmick by many analysts, leaves the long-term outlook uncertain. Few observers, however, expect EGTRRA to disappear entirely. The President and many congressional members have already proposed making the provisions permanent.

Around the time of EGTRRA, support for tax relief was high, though policymakers disagreed over how it should be accomplished. The original blueprint President Bush sent to Congress contained little relief for working poor families. In the Senate, a bipartisan coalition succeeded in adding provisions targeting low- and middle-income families. To critics’ dismay, the largest share of the tax cut still goes to families with incomes over $200,000; this group receives 46 percent of the total income and estate tax cut by 2010. But the bipartisan effort secured important victories for low- and middle-income working parents.

This brief describes the EGTRRA provisions that benefit low-income and middle-income families with children and estimates these two groups’ tax cuts over the decade. Revisions to three credits—the child tax credit, the child and dependent care tax credit, and the earned income tax credit—benefit the bottom half of the income distribution more than the top half.

Tax Relief for Low- and Middle-Income Families
EGTRRA changed almost every tax provision designed to help families. Combined, these changes will cost almost $660 billion. Two child-related provisions and three marriage penalty relief provisions target low- and middle-income families (though high-income families also benefit).

Child-Related Provisions
Child Tax Credit Increased from $500 to $1,000. Of all the provisions, the child tax credit increase—from $500 to $1,000—and the credit’s new refundability help low-income families most. The credit increased $100 in 2001, rising to $600. The next $100 jump occurs in 2005. The credit doubles to $1,000 by 2010 (table 1). Although many families will clearly benefit, the gains actually amount to less than the advertised “doubling” because inflation takes a bite out of the credit’s value. In real terms, the credit will increase by about half. Making the credit partly refundable helps even more parents. Under previous
law, most families could only apply the credit’s value toward their income tax bill. Therefore, families owing no taxes could not use the credit; families owing less than the credit’s value forfeited the difference. Under EGTRRA, the credit is refundable for up to 10 percent of earnings over $10,000 (upped to 15 percent in 2005). For example, a one-child family earning $16,000 in 2001 could claim the full $600 credit whether or not it owed income tax. The refundable credit amounts to a 10 percent tax subsidy (15 percent subsidy in 2005) on each dollar earned in the credit’s phase-in range. That subsidy was designed to mitigate the high marginal tax rate created by the phaseout of the EITC. In 2001, more than 14 million children benefited from the credit’s partial refundability. By 2010, more than 18 million children are expected to benefit.

More Expenses Eligible for the Child and Dependent Care Tax Credit. The nonrefundable child and dependent care tax credit (CDCTC) offsets the costs of child care while working or studying. The new law raises the maximum expenses eligible for this credit from $2,400 to $3,000 per child (a maximum of $6,000 per family) in 2003. The extent families benefit from this increase, however, depends on their child care bills. According to recent estimates, only 40 percent of low-income families (incomes below 200 percent of the poverty threshold) pay for child care. For these low-income families, child care expenses average $2,600 annually, well below the $4,800 limit in effect in 2000 (Giannarelli and Barsimantov 2000). Thus, increasing allowable child care expenses does not help many lower-income families. Moreover, like the child tax credit, the CDCTC is not indexed for inflation. By 2010, the allowable expense amount will be worth slightly less, in real terms, than in 2000. Nonetheless, without the new law, the value of the maximum expense allowed would have shrunk more than 20 percent by 2010.

EGTRRA also increases the maximum credit rate for low-income families—raising it from 30 percent to 35 percent for families with incomes below $15,000. Unfortunately, few taxpayers benefit because people at that income level generally do not owe enough taxes to use the full credit. Moreover, like the credit itself, the income levels determining the credit rate are not indexed for inflation. As a result, over time, higher credit rates apply to lower and lower levels of real income. For most families, the maximum credit will rise from $960 (20 percent of $4,800) to $1,200 (20 percent of $6,000).

Marriage Penalty Relief

Three provisions aim to prevent most couples from owing more income taxes when married than if single. First, increasing the point where the earned income tax credit (EITC) begins to phase out for married couples reduces benefit losses due to marriage, helping low-income families. Second, married couple’s increased standard deduction (beginning in 2005) lowers income tax liability, primarily benefiting middle-income families. Third, the expanded 15 percent tax bracket for married couples (starting in 2005) lowers many couples’ tax rates, benefiting upper-income households.

**EITC Phaseout for Married Couples Increased; EITC Rules Simplified.** The EITC, the largest refundable credit, is worth a percentage of earnings up to a certain income level (based on the household’s number of children). Within a specified income range, dubbed “the plateau,” the credit’s value remains set. Once earnings exceed that range, the credit decreases, until it phases out altogether.

Previously, the EITC often imposed hefty marriage penalties on low-income couples. Consider a couple with two children in which each parent earns $16,000. If unmarried, the head of household would have qualified for $3,186 in EITC benefits in 2000. If the couple married, however, their combined income, $32,000, would have disqualified them from receiving the EITC. By marrying, this middle-income couple would have lost about 10 percent of their combined income.

To reduce such penalties, EGTRRA raises the EITC phaseout for married couples in $1,000 increments, ultimately reaching $3,000 in 2008 (table 2). By 2008, the credit will

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**TABLE 1. Child-Related Tax Credits Modified by EGTRRA**

<table>
<thead>
<tr>
<th></th>
<th>2000</th>
<th>2001</th>
<th>2003</th>
<th>2005</th>
<th>2009</th>
<th>2010</th>
</tr>
</thead>
<tbody>
<tr>
<td>Child tax credit:</td>
<td>$500(^a)</td>
<td>$600(^b)</td>
<td>$700</td>
<td>$800</td>
<td>$1,000</td>
<td></td>
</tr>
<tr>
<td>maximum credit</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Child and dependent</td>
<td>$2,400 ($4,800 max)</td>
<td>$3,000 ($6,000 max)</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>care tax credit:</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>maximum expenses per child</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Minimum and maximum</td>
<td>30% for income &lt; $10,000</td>
<td>35% for income &lt; $15,000</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>credit rates</td>
<td>20% for income &gt; $28,000</td>
<td>20% for income &gt; $43,000</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

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\(^a\) Generally, the credit is nonrefundable. A family with three or more children can receive a refundable child credit to the extent that the employee share of Social Security taxes plus individual income taxes exceeds its earned income tax credit up to the amount of the full child credit.

\(^b\) Refundable up to 10 percent of earnings over $10,000 (earnings ceiling indexed for inflation after 2002); credit refund rate increases to 15 percent in 2005. Credit amount is not indexed for inflation.
not begin phasing out until income reaches $15,124 (in 2000 dollars), compared with $12,690 in 2000. The law also raises the end of the phase-out. By 2008, a family can have $33,586 in income (in 2000 dollars) before its EITC benefits end (versus $31,152 before the new law).

Like the other provisions, the law’s failure to index the credit for inflation and the gradual phase-in take a toll. By 2008, the $3,000 increase, adjusted for inflation, will be worth just $2,434 in 2000 dollars. Nonetheless, the EITC adjustments significantly increase the credit’s value among some married couples formerly penalized. And after 2008, the increase will be indexed for inflation.

The EITC provisions also simplified eligibility. The new rules align the definition of a qualifying child with other parts of the tax code and use adjusted gross income—versus the more confusing modified adjusted gross income—to calculate benefits. In addition, the new law gives parents whose children live with them first right to claim the EITC and grants foster parents the credit for children living with them for 6 months out of the year (reduced from 12 months). EGTRRA also helps the IRS identify ineligible noncustodial parents trying to claim the credit. (Department of the Treasury 2002).

**Standard Deduction and 15 Percent Tax Bracket Increased.** EGTRRA increases the standard deduction for married couples. By 2009, the standard deduction for joint returns will be double that for single filers. The 15 percent tax bracket for joint returns will also become twice as large as the bracket for single returns (table 2). These provisions will eliminate most middle-income marriage penalties, but like the EITC provision, they cut taxes for couples who pay less owing to marriage (i.e., they increase marriage “bonuses”).

The increase in the income range taxed at the 15 percent rate only affects couples taxed at rates above 15 percent. In 2000, less than 40 percent of all joint filers fell in the 28 percent tax bracket or higher.

**New Bracket Created; Marginal Tax Rates Lowered.** EGTRRA created a new 10 percent tax bracket and will cut rates for people in the 28 percent tax bracket and higher (table 3). Of the two provisions, just the 10 percent bracket, which applies to singles’ first $6,000 of income and to joint filers’ first $12,000 of income, aids lower-income households. Even the new bracket, however, only helps households with taxable income. Oddly, the new law also temporarily reintroduces “bracket creep” for low-income households—a widely criticized phenomenon eliminated for everybody else 20 years ago. For the first seven years, the 10 percent bracket is not indexed for inflation. So, as low-income households’ earnings increase with inflation, more and more income will creep into the 15 percent tax bracket. The damage is undone in 2008, when the single-filer threshold will increase by $1,000 and the joint threshold by $2,000—an adjustment that roughly offsets inflation’s effect. In 2009, the 10-percent bracket, like all other brackets, becomes inflation-indexed.

**Overall Effects of the Legislation**

The level of tax-free income provides a simple metric of how the tax system affects low-income people. In 2000 dollars, the increase in the entry threshold is uneven because of the complex phase-ins and the failure to index the child tax credit expansion for inflation. For single childless taxpayers, the 10 percent bracket increased the entry threshold slightly in 2001; the level is set to remain constant after that. By contrast, increases in tax-entry thresholds for families...
with children phase in over several years. Between 2000 and 2010, tax-free income for a single parent with one child will increase more than $2,000; for a married couple with two children, the increase is more than $5,000; and for a married couple with four children, the increase is more than $12,000 (figure 1). However, these increases phase in over many years. Indeed, between 2001 and 2007, the tax-free level of income changes very little; in some years, it actually declines.

On balance, the income tax cuts favor families with children over those without children, especially among those low- and moderate-income families. But the largest tax benefits, by far, accrue to high-income households, whether or not they have children. High-income households’ relative gains become even more pronounced when the analysis includes the effects of the estate tax.13

The gradual phase-in of most major EGTRRA provisions dramatically changes the distribution of the tax-cut benefits over the decade. Low- and moderate-income taxpayers receive immediate benefits, owing to the new 10 percent tax bracket and the bigger, partially refundable child tax credit. Their share of the tax cut then declines until mid-decade, when further increases in the child tax credit, as well as changes to the EITC and other provisions aimed at married couples, take effect (figure 2). In the second half of the decade, an increasing share of the cut each year goes to taxpayers with adjusted gross income below $50,000.

High-income taxpayers (above $200,000) also gain more from the income tax cuts that phase in later in the decade. Many provisions targeting high-income taxpayers—including top marginal rate cuts and the repeal of the limitation on itemized deductions and the phaseout of personal exemptions—take effect after 2005. By contrast, middle-income taxpayers see a shrinking share of the cuts through the second half of the decade, mainly because many fall prey to the alternative minimum tax (AMT). Taxpayers owe AMT when their ordinary income tax liability falls below the AMT. Since EGTRRA cut ordinary income tax rates while leaving the AMT unchanged (except for the temporary fix, expiring in 2004), millions of mostly middle-income taxpayers will fall into this trap. Because the AMT does not allow personal exemptions, families with children are especially likely to be hit by the AMT.

The percentage increase in after-tax income following the cuts captures the additional resources families have available for consumption or saving. By this measure, the poorest individuals, those with incomes below $10,000, receive the smallest benefit once EGTRRA completely phases in (table 4). Taxpayers with

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<table>
<thead>
<tr>
<th>Year</th>
<th>Married with 4 children</th>
<th>Married with 2 children</th>
<th>Single with 1 child</th>
</tr>
</thead>
<tbody>
<tr>
<td>2000</td>
<td>$20,000</td>
<td>$5,000</td>
<td>$1,000</td>
</tr>
<tr>
<td>2001</td>
<td>$22,000</td>
<td>$5,500</td>
<td>$1,500</td>
</tr>
<tr>
<td>2002</td>
<td>$24,000</td>
<td>$6,000</td>
<td>$2,000</td>
</tr>
<tr>
<td>2003</td>
<td>$26,000</td>
<td>$6,500</td>
<td>$2,500</td>
</tr>
<tr>
<td>2004</td>
<td>$28,000</td>
<td>$7,000</td>
<td>$3,000</td>
</tr>
<tr>
<td>2005</td>
<td>$30,000</td>
<td>$7,500</td>
<td>$3,500</td>
</tr>
<tr>
<td>2006</td>
<td>$32,000</td>
<td>$8,000</td>
<td>$4,000</td>
</tr>
<tr>
<td>2007</td>
<td>$34,000</td>
<td>$8,500</td>
<td>$4,500</td>
</tr>
<tr>
<td>2008</td>
<td>$36,000</td>
<td>$9,000</td>
<td>$5,000</td>
</tr>
<tr>
<td>2009</td>
<td>$38,000</td>
<td>$9,500</td>
<td>$5,500</td>
</tr>
<tr>
<td>2010</td>
<td>$40,000</td>
<td>$10,000</td>
<td>$6,000</td>
</tr>
</tbody>
</table>

*Source:* Urban Institute calculations. In calculating the year 2000 values of 2001 tax law in subsequent years, we use projections for inflation from the Congressional Budget Office, August 2001. Calculations do not include dependent care credit.

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**FIGURE 2. Share of the Income Tax Cut Going to Families at Different Strata of the Income Distribution, Calendar Years 2001-2010**

- **Over $200K**
- **$50K-$200K**
- **$0-$50K**

*Notes:* Includes provisions affecting marginal tax rates, the 10% bracket, the child tax credit, the child and dependent care credit, the limitation of itemized deductions, the personal exemption phaseout, the AMT, and the standard deduction, 15% bracket, and EITC provisions for married couples. Excludes pension and IRA provisions and phaseout of the estate tax. AGI measured in 2001 dollars.
The repeal of the estate tax, one of the largest revenue measures included in EGTRRA, will cost more than $53 billion when fully phased in (JCT 2001). The provision almost exclusively benefits taxpayers with very high incomes; it only affects those who have assets worth more than a million dollars at the time of death. Including the estate tax repeal raises the percentage increase in after-tax income for individuals in the highest adjusted gross income class about two-thirds and raises their share of the tax cut from 37 percent to 46 percent (table 5).

**Overall Effects on Taxpayers with Children**

Not surprisingly, since many EGTRRA provisions target taxpayers with children, parents fare better than childless taxpayers overall. By 2010, when all child-related provisions are fully phased in, families with children receive a significantly larger percentage increase in after-tax income, especially families with income in the $10,000–$50,000 range (table 4). Parents also receive a larger average income tax cut than childless taxpayers. In 2009 and 2010, when the final two steps of the child tax credit phase in, the tax advantage for taxpayers with children widens significantly. By 2010, parents receive an average income tax cut of about $1,620—almost 80 percent larger than the average $900 cut for childless individuals.

The gains for families with children vary by income. The difference is most pronounced among lower- and middle-income taxpayers because many child-related provisions directly target those income groups. In 2001, the average tax cut for low-income parents (adjusted gross income of $10,000–$30,000) was more than 70 percent larger than childless individuals’ average cut (figure 3). Taxpayers with and without children reporting $50,000–$50,000 in income fared about the same in 2001. High-income taxpayers (those with over $200,000 of AGI) also benefit more if they have children, but the difference between the two groups is not as great, partly because they are not eligible for the expanded child tax credit.

In 2010, low- and moderate-income parents ($10,000–$50,000) benefit the most, because the child-related provisions finally take full effect (figure 3). In that year, the average tax cut for parents in both income classes is about two-and-a-half times the size of that received by childless taxpayers. However, in the highest-income range, parents receive a smaller average tax cut. These parents’ incomes are too high to qualify them for the child tax credit. And the small gains from the increased child and dependent care credit and the repealed personal exemptions phaseout are more than offset by the AMT. Parents are much more likely to be liable for the AMT. In addition, as noted earlier, AMT taxpayers do not benefit from most EGTRRA provisions.

### Future Policy Questions

Many of EGTRRA’s provisions phase in very slowly, making the law’s overall effect on the tax system difficult to predict. The sunset provision also makes future tax burdens uncertain. Although many lawmakers would like to make EGTRRA’s provisions permanent, the reemergence of budget deficits and the high costs of extending many EGTRRA provisions raises the possibility that at least some of the tax cuts might be scaled back, or eliminated, by 2011.

Some provisions are supposed to disappear even before the entire law is fully in place. The estate tax provision, for example, only phases in over a two-year period, beginning in 2001. High-income taxpayers (those with over $200,000 of AGI) also benefit more if they have children, but the difference between the two groups is not as great, partly because they are not eligible for the expanded child tax credit.
The EITC into a single child-assistance children with the child tax credit and combining personal exemptions for taxpayers’ lives easier. For example, these benefits would make many tax—requirements, and administration of the various child-related tax benefits. Putting the credit more complex. Child tax credit; indeed, it made com—simplify the complicated refundable EITC. But it missed an opportunity to income families when they prepare their taxes. EGTRRA did simplify the unnecessary complexity facing lower—taxpayers from paying the compli—sunsets. The provision relieving some taxpayers from paying the complica—dual income taxes exceeded a family’s EITC. This change would also make the tax system more pro—since low-income families gain more from refundable tax credits than from deductions and nonrefund—able credits. Replacing personal exemptions for adults with higher standard deductions would also sim—plify and add progressivity to the system (Feenberg and Skinner 1993). Since most high-income households tend to itemize, larger standard deductions would mostly benefit lower— and middle-income families.

**Endnotes**

1. This brief is a very abbreviated version of Burman, Maag, and Rohaly (2002). For a more comprehensive discussion of EGTRRA, see Gale and Potter (2002).

2. The cost includes both tax revenue decreases and increased outlays on refund—able tax credits (JCT 2001).

3. At its maximum, the child tax credit is worth $772 (in 2000 dollars).

4. Previously, the child tax credit was only refundable to families with three or more children to the extent that the employer share of Social Security taxes plus individual income taxes exceeded a family’s EITC.

5. The taxpayer’s earnings exceed $10,000 by $6,000; 10 percent of $6,000 equals $600. See Greenstein (2001) for an excellent dis—cussion of the issues surrounding the expansion of the child tax credit and the EITC.

6. For more on the logic behind the refundable child tax credit and its effect on poor families and work incentives, see Sawhill and Thomas (2001a; 2001b).

7. The CDCTC may also be used to pay for the costs of care for a disabled or elderly dependent.

8. After adjusting for inflation, the maximum allowable expense per child declines from $2,400 in 2000 to $2,316 in 2010.

9. For example, the phaseout rate for taxpayers with two or more qualifying children is 21.06 percent. That is, for every $100 earned, taxpayers lose $21.06 of EITC, amounting to a surtax of 21.06 percent in the phaseout range.


11. The couple would also owe more tax before credits by virtue of being married, so that its total marriage penalty would exceed $3,186.

12. The lower tax rates for upper-income taxpayers also roughly double the number of people subject to the AMT over the next.
10 years. If Congress does not take action, more than half of all families of four or more will be subject to the AMT by 2010.

13. See Burman, Maag, and Rohaly (2002) for a description of the Urban-Brookings Tax Policy Center’s Microsimulation Model, which was used to generate the data on EGTRRA’s distributional impacts. The 2002 paper also contains more detailed breakdowns of the distributional impact for selected calendar years from 2001 through 2010.

14. An increasing number of middle-income people were becoming subject to the AMT even before EGTRRA, because the ordinary income tax is indexed for inflation while the AMT is not. Thus, the normal increase in nominal incomes causes AMT liability to increase but leaves ordinary income tax liability unchanged. People who would have been paying the AMT before 2001 do not benefit from EGTRRA’s income tax rate cuts.

References


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The Tax Policy Issues and Options series is part of the Tax Policy Center, a joint venture of the Urban Institute and the Brookings Institution.

The Tax Policy Center (TPC) aims to clarify and analyze the nation’s tax policy choices by providing timely and accessible facts, analyses, and commentary to policymakers, journalists, citizens, and researchers. TPC’s nationally recognized experts in tax, budget, and social policy carry out an integrated program of research and communication on four overarching issues: fair, simple, and efficient taxation; long-term implications of tax policy choices; social policy in the tax code; and state tax issues.

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