Columbia University

The Clearinghouse on International Developments In Child, Youth and Family Policies

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TAX DAY: HOW DO AMERICA'S CHILD BENEFITS COMPARE?

As April 15th approaches and American families with children fill out their tax returns, they will find some relief in the form of newly expanded child tax credits ($600 per child). These credits that began modestly during the Clinton administration will increase further during the Bush administration and beyond, reaching $1,000 per child in 2010. While many families are delighted to have these expanded credits, as they should be, we cannot neglect the fact that Americas still receive dramatically less support with regard to the costs of rearing children than families in many other countries.

The United States stands apart as one of the few industrialized nations that does not provide *child or family allowances*, cash benefits given to families with children depending on the presence, number, age, and sometimes the ordinal position of children *(see Table 1)*. However, the United States does provide several *tax benefits* to families with children. Low-income working families can apply for the refundable Earned Income Tax Credit. There is also the Child Tax Credit. The credit is per child and is now refundable for low-income families. The government also helps offset child care (and dependent care) costs by offering a tax credit for up to 30 percent of some of these expenses for working families. For the family living on average earnings, the value of these tax credits is likely to equal about six percent of their income. There are also tax credits for families adopting a child, paying for a child's education and for the cost of a child in eligible child care.

Unlike most other industrialized countries, family benefits for American's with children do not come in a neat package. Applying for tax benefits is more confusing in the United States because it requires that a family be aggressive and savvy enough to understand the tax system. The net effect is that those American families who most need assistance are the least likely to apply or be aware of the benefits, and when they do apply, assistance is likely to come once a year, rather than on a monthly basis.

It is important for Americans to know on tax day that while they may be receiving an added tax credit; these tax concessions do not make up for the lack of child allowances and other special cash benefits targeted on children and available in many other countries. Despite its recent lower rates, the United States' child poverty rate still ranks among the highest in the industrialized world. Perhaps it is time for the United States to learn from its neighbors and increase its investment in rearing American children.

Family and Child Allowances Internationally

Currently 88 countries, worldwide, provide child or family allowances. In some countries, family allowances may be supplemented by birth grants, school grants, child rearing or child care allowances, adoption benefits, special supplements for single parents, guaranteed minimum child support benefits, and allowances for adult dependents and disabled children. The allowance may also vary by family composition, income, the employment status of the parents, and geographic region. By providing these cash benefits, governments are directly helping families with the costs associated with raising children and indirectly helping to lower the rate of child poverty.

In recent years, some countries have begun to deliver their family allowances through the tax system or have substituted targeted tax benefits for family allowances, or supplemented their allowances by targeted child or family tax benefits. In Australia, Canada, Iceland, and New Zealand, for example, child benefits may depend on income level, and are provided and administered through the tax system either as a reduction of income taxes or a cash payment to families with children, much like a negative income tax system. While the United States has no family allowance it does provide tax benefits for families with children. In other words, for a full picture of how countries provide additional income to families with children currently, both tax and cash benefits must be considered.

Definitions

Universal Child Benefits: *(also referred to as a family benefits, or a child or family allowances)****:*** cash payments to families with children regardless of parental income. The benefit amount may vary by the ordinal position of the child, the age of the child, and/or the employment status of the parent.

Income-Related Child Benefits**:** similar to universal benefits, but eligibility and benefit levels vary by income and are usually limited to families with children whose income is below a certain amount.

Tax Deduction or Allowance**:** amount subtracted from the taxable income base before calculating tax liability. The value of the allowance depends on the marginal rate of taxation and is of greater value to taxpayers with higher incomes. Allowances may be transferable between spouses.

Tax Credit**:** reduction in tax liability after assessing tax obligations. The value of the credit may vary according to family size, family composition or marital status, and the credits may be transferable between spouses. The tax credit may be refundable to benefit those families whose income is below the level of taxable income.

Purpose of Family Allowances

Family allowances have served diverse purposes over time in different countries. In a few countries, they were motivated by pro-natalist objectives, but that goal has largely disappeared now and there is no evidence that they were effective. Typically, family allowances have one or more of the following objectives:

- *horizontal equity* – the redistribution of income from childless households to families with children, in recognition of the heavier financial burden incurred by child-rearing.
- *vertical equity or redistribution*– supplementing the incomes of poor and modest income families with children as a means of reducing or preventing poverty.
- *strengthening labor force attachments* – in some countries, benefits are only available to families with children who have at least one parent in the work force, or higher benefit levels are offered to families attached to the labor force.
- *social inclusion/exclusion* – particularly as the European Union moves toward greater unity among its member states, family allowances are viewed as an instrument that can foster societal cohesion and progress.

Benefit Levels *(see Table 2)*

For the most part, family allowances are modest benefits worth a little less than 10 percent of average wages for each child, but they can contribute a significant component of family income to large or low-income families.

Family allowance benefit levels vary in different ways. Several countries provide a uniform rate per child, regardless of the number of children in the family (Australia, Spain, Norway, and Sweden) while in other countries (Italy, Belgium, France, Germany, and Luxembourg), benefits increase with each additional child or are larger for later children (such as the 3rd, 4th or 5th child). In still others, such as the United Kingdom, the benefit is higher for the first child while in France, a family is only eligible for the allowance after the second child is born.

Age of children may also affect the benefit level. Many countries provide higher benefits for older children (Austria, Belgium, France, Luxembourg, and the Netherlands). Some countries provide a higher or special benefit for families with very young children (Austria, France, Germany and Portugal) to make it possible for a parent to remain at home during a child's early years (until the child is age three, age one in Portugal). In Finland and Norway parents have the option of a subsidized place in child care or a cash benefit of equivalent value making it possible for a parent of a very young child (under 3) to stop working and provide care.

Benefit levels may also be reduced as income rises or by including the benefit in taxable income, as in Spain and Greece.

Most countries offer higher benefit levels or supplements for children with disabilities.

In some countries, benefit levels vary by geographic regions. Austria, Germany and Spain offer national benefits that vary by state, due to differences in the cost of living. Norway, too, supplements the family allowances of families in the Arctic region.

Eligibility and Coverage

Family allowances may be universal, income-related, or depend of the employment status of the parents. In most countries, coverage with regard to the basic benefit is universal, though recent trends suggest that income-related benefits are growing, targeting benefits on families with children whose incomes are below a certain level. Australia, Canada, Greece, Iceland, Ireland, Italy, Japan, New Zealand, Portugal and Spain, have income-related or income-tested benefits. Some of the countries listed in Table 1, offer universal allowances and supplement these benefits with means-tested allowances for low-income, single-parent, or large families (for example, Austria, France, Ireland and the United Kingdom).

Several countries restrict benefits to working families, families with at least one employed parent, although this requirement has disappeared in most countries. Nonetheless, it still exists in a few. For example, in Belgium and Greece benefits are provided to salaried workers and separate systems exist for private and public employees. In Greece, employees receiving the equivalent of family allowances from their employer are excluded from public coverage.

Countries demonstrate differences in their residency requirements. Most countries offer benefits to all residents, regardless of their citizenship, however, several countries add the requirement that a resident parent be employed in the country. Some countries provide the benefit even when the children covered live in another country (Germany, for example). Residency and citizenship requirements are becoming increasingly important issues as mobility grows within the European Union and benefits differ among the countries.

Coverage is generally extended to children from the time of birth to the age of majority or completion of formal education, provided other eligibility criteria are met. Many of the countries extend child benefits through the completion of a child's formal education or training, or provide benefits for unemployed youth. The maximum age limit an individual can qualify is 26 years, in both Austria and Germany, but disabled children may qualify regardless of age. For example, Austria, Belgium, Germany, Greece, Spain, Italy, and Luxembourg, have no age limits for child benefits for children classified as disabled, though the benefit level may vary according to age and severity of disability (Spain).

Tax Credits and Deductions

Historically, countries have allowed tax exemptions or deductions for children. However, these were regressive, benefiting higher income families more than those with low incomes. In recent years, there has been increased use of the tax system, with specially targeted tax benefits providing income supports to families with children. Canada, United States, France, Germany and the United Kingdom have enacted and/or expanded existing tax credits to benefit families with children, often limiting them to working families.

Coverage and eligibility for tax benefits supporting families with children vary significantly across countries. Child benefits are used for the same purposes as cash benefits, however tax deductions and tax credits differ in their impact on family income. Tax allowances or deductions reduce taxable income before calculating tax obligations while tax credits reduce tax liabilities and thus have the same value to all who pay income tax. However, unless these tax credits are "refundable" or "non-wasteable" (like the United States EITC), meaning that those with incomes below the tax threshold receive a cash benefit, they are limited in value to more affluent families. Australia, Belgium, Canada, Italy, Netherlands and Spain target tax benefits to families with younger children. Austria, Germany, Ireland, Luxembourg and the Netherlands have tax deductions and credits that specifically assist single-parent families with children. The United States and U.K. have refundable tax credits benefiting low-income working families. Countries with credits or higher credits to single-earner families with children include Austria, Greece, Canada and Australia.

Recently, Canada, Australia, New Zealand and Iceland have shifted the administration of their cash benefits from their social welfare system to their respective tax ministries. Though called a tax benefit in each of these countries, the benefit continues to be a cash benefit.

Who Receives the Benefits? *(see Table 3)*

In almost all the industrialized countries, the universal cash child allowance is awarded to the mother, or to the person caring for the child (or to a lone parent), in both cases, overwhelmingly the mother. The income-related cash benefit is more likely to go to the wage-earning parent or to either parent. Where tax benefits are concerned, however, the primary recipient is usually the taxpayer or head of household, most often the father.

United States Tax Benefits for Families with Children

Standard Deduction – is the amount that can be subtracted from the adjusted gross income to figure taxable income. The standard deduction is for taxpayers who do not itemize deductions (income is generally below $132,950 for couples and $66,950 for singles). For 2001, the standard deduction for a married couple with dependent child(ren) was $7,600.

Child Tax Credit – is a federal tax credit to help families with the costs of rasing children up to the age of 17. The credit is worth up to $600 per child for single parent whose income is $75,000 or less, and for married parents whose income is between $75,000 and $110,000. The credit decreases as income increases above these income limits. For the first time, the credit will be partially refundable this year for eligible workers who earn above $10,000.

The Child and Dependent Care Credit –is a non-refundable tax credit for employment-related care expenses for children under 13 years or qualifying dependents. For lower income families, the credit can be as much as $720 for one child, and $1,440 for two or more. The amount of this credit depends on family income, the number of children or dependents in care, and the cost of care (the credit is limited to a portion of expenses of up to $2,400 for one and $4,800 for two or more children or dependents). Individuals and couples who are working and pay taxes may be eligible for a partial credit at all income levels, assuring them of a tax benefit worth at least $480 for one child and $960 for two or more if their income is above $48,000.

Earned Income Tax Credit (EITC) – is a refundable federal tax credit for employed persons with moderate incomes. For families with children the maximum credit for 2001 ranges from $2,428 to $4,008 depending on the number of children and family income. To be eligible, families with one child must have income below $28,281, and under $32,121 for families with two or more children.

Adoption Credit – a tax credit of up to $5,000 ($6,000 for the adoption of a child with special needs) for expenses related to the adotpion of a child. The credit is reduced if the family income is between $75,000

Conclusion

For a long time, the United States was an outlier in not providing a child or family allowance, but only the standard tax allowance or exemption that most other countries provided as well. Over the last two decades, however, especially the last decade, the United States has increasingly turned to the use of tax credits, both refundable and non-refundable, but either limited to working families (EITC) or non-refundable and limited to better off families (Child and Dependent Care Tax Credit) or only partially refundable (Child Tax Credit). The device of the tax credit, especially refundable credits, has been adopted by other countries as well (UK, Canada, Israel, Germany). The line between the two benefit systems has become increasingly blurred. In comparing the extent to which countries supplement the incomes of families with children, it has become essential that both direct cash payments and tax benefits be included, and attention be paid to the impact that both have on disposable income. The EITC has had a significant impact on reducing the poverty of low-income working families with children. Nonetheless, the United States still does not have a benefit that supplements family income for <u>all</u> families with children, regardless of income or employment status. Nor does it have many of the special child cash benefits that exist in other countries.

Throughout the second half of the twentieth century, the dominant pattern in countries desiring to supplement the incomes of families with children or, as it is sometimes described, in equalizing the financial burden of those with and those without children, have been child or family allowances - cash benefits based on the presence and number of children in a family. Tax benefits, both credits and allowances targeted on children or families with children have emerged as a parallel strategy, and in recent years the line between the two systems have become increasingly fudged. Ultimately, the issue is how much reaches families with children. Given its child poverty rates and evidence of deprivation, the United States might want to consider enriching its package.

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Additional information on child and family allowances is available at The Clearinghouse on International Developments in Child, Youth and Family Policies website www.childpolicyintl.org or by calling Tamara Cannon at (212) 854-9007. Still available upon request (and on our website) are issue briefs on early childhood education and care, survivor benefits, and unemployment benefits. The Clearinghouse provides cross-national, comparative information about the policies, programs, benefits and services available in advanced industrialized countries to address child, youth, and family needs. The Clearinghouse is funded by the W.T. Grant Foundation.

The Clearinghouse periodically sends updates regarding international developments in child, youth and family policies. If you know of someone interested in receiving these updates, please refer them to our website where they can register for our on-line updates. If you wish to be taken off our mailing list please contact us at childpolicyintl@columbia.edu.

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