Tax Simplification: Clarifying Work, Child, and Education Incentives

By Elaine Maag

Elaine Maag is a senior research associate at the Urban Institute and Tax Policy Center. The author thanks Donald Marron, Jim Nunns, C. Eugene Steuerle, and Roberton Williams for helpful comments. All errors or omissions are the author's own.

The federal income tax code is riddled with complex provisions concerning children. Families with children qualify for and receive substantial assistance, but the provisions are difficult for parents to understand and for the IRS to administer. This article proposes making uniform the definition of child — under age 19, regardless of student status — for the key child benefits: the earned income tax credit, the dependent exemption, head of household filing status, and the child tax credit. Savings from the proposal could be used to subsidize higher education, particularly for low-income families that would lose assistance from the EITC. The proposal would simplify the tax system, clarify incentives, and set the stage for broader reform.

A. Introduction

The code provides substantial benefits to families with children through a wide array of child-focused tax provisions. Those provisions either reduce taxes owed, relative to individuals and families without children, or provide a direct benefit akin to a traditional spending program, albeit administered through the tax system. Those provisions have two primary goals: to adjust tax burdens for a family's ability to pay and to encourage particular behaviors, most notably work. The child tax credit (CTC), the earned income tax credit, the dependent exemption, head of household filing status (granted to single parents), and the child and dependent care tax credit (CDCTC) are the core child provisions. Congress enacted those provisions piecemeal, with the result that families with children now face considerable complexity when completing their tax return.

Beyond those broad child subsidies exist myriad college subsidies for children and their parents, including the American opportunity tax credit (AOTC), the deduction for tuition and fees, and the lifetime learning credit. Benefits from those provisions depend on having college expenses, creating a clear link between the subsidy and college attendance. Other college subsidies in the tax system, such as the EITC, dependent exemption, and head of household filing status, are less obvious, in part because they don't go exclusively to students' families. Those subsidies end when children reach age 18, except when children between 19 and 23 are full-time students for at least five months of the year. Because those benefits are not linked to college expenses, there's no obvious connection between the child's attending college and the family's receiving benefits. The student exception in those provisions increases complexity for families and makes the IRS's job of administering the tax code more difficult.

This article reviews prior simplification efforts and current law, and analyzes a proposal to apply a uniform age test of under 19 years old for the CTC, EITC, dependent exemption, and head of household filing status. The proposal would save an estimated $900 million, which could be used to enhance college assistance for low-income families to offset losses from the EITC for those families. A discussion of the proposal concludes this article.

The proposal would simplify the tax system and enhance the effectiveness of the child-related provisions and the college subsidies. The less complex child-related provisions would be easier for the IRS to administer and for families to understand. The proposal also could serve as a stepping stone to further reforming the child and work incentives into two distinct credits.

B. History of a Uniform Definition of Child

As discussed in Maag (2010), Maag et al. (2011), and Mumford (2009), myriad tax provisions benefit families with children, including the CTC, the EITC, the dependent exemption, head of household filing status for single parents, and the CDCTC. Different eligibility rules mean that families can qualify for some provisions and not for others.

Many observers have called for reforming the child provisions in the tax code,[1] with some focused on creating a simple child benefit and others seeking to apply a uniform definition of child to existing provisions. The latter approach culminated in the Working Families Tax Relief Act of 2004 (WFTRA), which simplified the child rules by making three tests for eligibility — based on residency, relationship, and support — almost uniform. All three tests apply to the CTC, the dependent exemption, head of household status, and the CDCTC, and all but the support test apply to the EITC (see Table 1). WFTRA also created a tiebreaker rule that applies when more than one taxpayer can claim a child. There are exceptions, but the rules cover almost everyone eligible for the credits.

Under WFTRA, a qualifying child must:

[1] A summary of the issue was published by Treasury economists Holtzblatt and McCubbin (2003).

Table 1. Summary of Tests for Qualifying Child and Qualifying Relative						
	Head of Household*		Dependent Exemption*		EITC	CTC
	Qualifying Child	Qualifying Relative**	Qualifying Child	Qualifying Relative**	Qualifying Child	Qualifying Child
Relationship	X	X	X	X	X	X
Age	Under 19 or 19-23 and in school		Under 19 or 19-23 and in school		Under 19 or 19-23 and in school	Under 17
Residency	X		X		X	X
Support	X	X	X	X		X
Gross income		X		X		
Member of household		X		X		

Source: IRS, 2010 a, b, c.
*If a person does not meet the test for qualifying child, they can qualify for benefits if they meet the tests for qualifying relative.
**Qualifying relatives must meet either the relationship *or* member of household test, not both.

Relationship — Be the taxpayer's child or stepchild (with respect to blood or adoption), foster child, sibling or stepsibling, or a descendant of one of those.

Residence — Live with the taxpayer for more than half the tax year. Exceptions may apply for children of divorced or separated parents, kidnapped children, temporary absences, and children who were born or died during the year.

Support — Not provide more than half his own support for the year. Note: This test does not apply to the EITC.

Tiebreaker — If more than one person can claim a child, assignment follows a specified order: (1) the parent; (2) if more than one taxpayer is the child's parent, the one with whom the child lived for the longest time during the year, or if the time was equal, the parent with the higher adjusted gross income; (3) if no taxpayer is the child's parent, the taxpayer with the highest AGI.[2]

Whether a taxpayer can claim benefits because of a child depends on the child's age. Children between ages 19 and 24 must attend school full time for a minimum number of months to qualify. WFTRA significantly simplified the situation but left in place different age limits for the various child provisions. Rules can quickly get complicated and difficult to administer. Children who do not meet the definition of child still may qualify their parents for head of household filing status or the dependent exemption as a "qualifying relative," if the child has gross income below a specified limit ($3,700 in 2011).[3]

C. Rationale for a Uniform Definition of Child

Imposing a uniform child age limit for the CTC, EITC, dependent exemption, and head of household filing status would significantly improve those provisions and simplify their administration. This analysis considers limiting those provisions to children age 18 or under with *no* exceptions for older children who are also full-time students. Imposing that limit would expand the population eligible for the CTC by allowing 17- and 18-year-olds to qualify and would contract the population eligible for the EITC by making students between 19 and 23 ineligible. Fewer taxpayers would qualify for the dependent exemption and head of household filing status because some children wouldn't satisfy tests for being a qualifying relative (which the proposal would not change).

Savings from those changes could be used to expand college assistance, making the total proposal revenue neutral while clarifying incentives in the tax system and targeting benefits toward those most likely to respond. Prior research has shown that subsidies must be simple and certain to effectively increase college attendance[4]; current subsidies in the child provisions violate the simplicity principle.

D. Analysis

Families with children generally pay less tax than families without children (who have the same income), and the difference can be substantial (see

[2]IRS (2005).

[3]Gross income includes not just wages and investment income but also some grants and scholarships — for example, grants used to pay room and board expenses.

[4]Dynarski and Scott-Clayton (2007).

Figure 1).[5] Under the proposal, the gaps would decrease or disappear altogether for families with children in college — depending on whether the family has other children not in college and whether those children would continue to qualify for some benefits as a relative rather than as a child.

How the policy would affect a family over their lifetime would depend in part on fluctuations in the family's income and the ages of their children. Families with low incomes tend to qualify for the relatively generous benefits of the EITC and CTC, but receive less assistance from the dependent exemption and head of household filing status than their higher-income peers. Families with higher incomes (for example, a single parent with one child and income exceeding $95,000) do not benefit from the EITC or CTC, but benefit more from the dependent exemption and head of household filing status than their lower-income peers. It is therefore possible that some families would see net benefits from the proposal while others would see their child-related benefits decline, relative to current law. Figure 1 shows how benefits change as a child ages and as income changes. Essentially, the policy would make families eligible for an additional two years of the CTC, for which almost all children in families with incomes below the threshold qualify, while eliminating the EITC benefits associated with student status and limiting benefits from the dependent exemption and head of household filing status associated with student status.

Table 2. Revenue Effect of Proposal, Relative to Current Policy, 2011

	Estimate, Assuming No Children Convert to Qualifying Relative Status (billions)	Estimate, Assuming Some Students Convert to Qualifying Relative Status (billions)
Extend CTC eligibility for 17- and 18-year-olds	-$6.1	-$6.1
Disallow EITC for 19- to 23-year-old students	$3.0	$3.0
Disallow dependent exemption for 19- to 23-year-old students	$4.5	$2.9
Disallow head of household filing status for 19- to 23-year-old students	$1.6	$1.1
Combined effect	$3.0	$0.9

Source: Urban-Brookings Tax Policy Center microsimulation model (version 0509-5) and IRS. First column shows estimate from microsimulation model where all students become ineligible for EITC, dependent exemption, and head of household filing status; second column shows estimate adjusted for some students converting from qualifying child to qualifying relative and retaining eligibility for the dependent exemption and head of household filing status under the proposal.

1. Comparing the proposal and current policy piece by piece. The proposal likely would save between $900 million and $3 billion in 2011 (see Table 2; the appendix explains the estimates). Effects would differ across income groups. The policy's effect on a family would change over time as their income rises or falls.

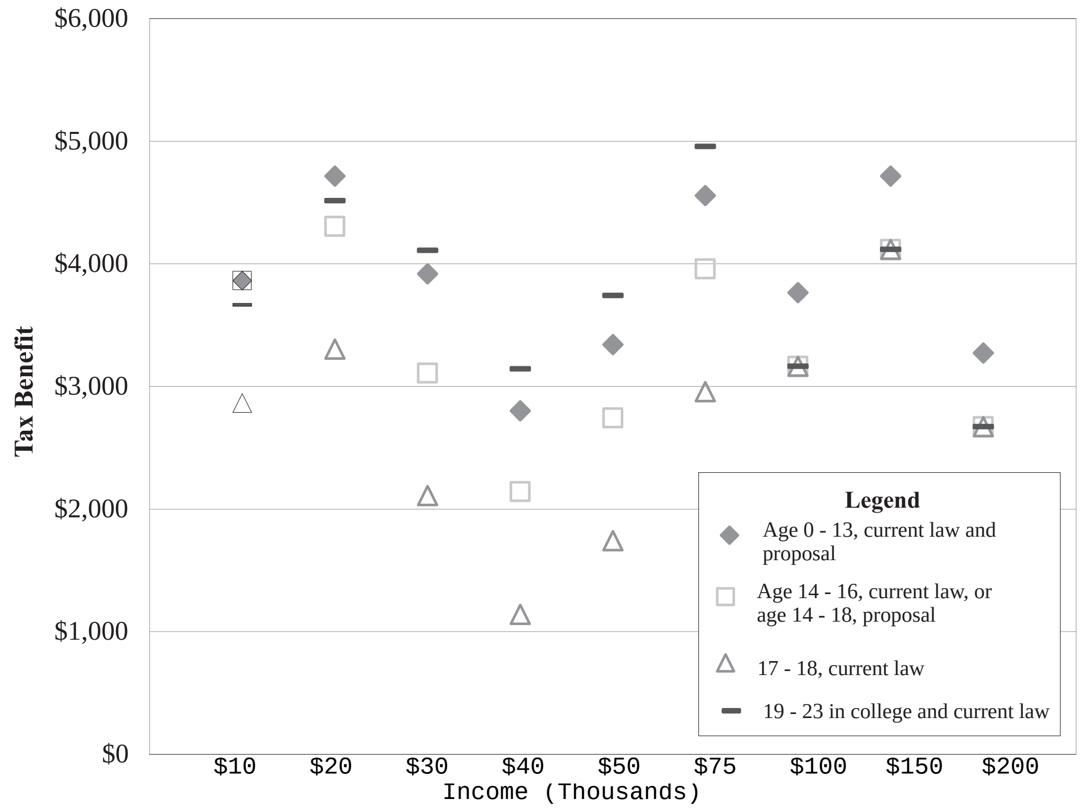
a. Expand the CTC. The proposed expansion of the CTC would give most families an additional $1,000 credit for each 17- or 18-year-old child. The credit phases in with income (after a legislated threshold ($3,000 in 2011)) at a rate of 15 percent and phases out once income exceeds $95,000 (single parent) or $130,000 (married couple). Some families have incomes that are either too high or too low to qualify. Among families with children meeting current age restrictions, 68.3 percent benefit from the CTC.[6] Under the proposal, many families can expect to receive an addition $2,000 in tax benefits for each child they have. The CTC expansion would cost an estimated $6.1 billion in 2011.

b. EITC. The proposal would reduce or eliminate the EITC for families with students between the ages of 19 and 23. If a family has at least three children under the age of 19, their EITC would be unaffected by the proposal. For families with fewer than three children under age 19, the effect of the proposal would vary. Having two qualifying children would reduce a family's EITC from 45 percent of earnings (a credit of up to $5,751) to 40 percent of earnings (a credit of up to $5,112). Families with one qualifying child can receive a maximum benefit of 34 percent of earnings (a credit of up to $3,094). Most families without qualifying children would receive no EITC.

[5]For purposes of this analysis, I assume that current policy is extended — which means the 2001, 2003, and 2009 stimulus provisions in the tax code do not expire and the alternative minimum tax continues to be patched to prevent millions of additional taxpayers from paying it. Notably, I assume that the CTC remains a $1,000-per-child, largely refundable credit that is not indexed for inflation over time. To the extent Congress opts to adopt a different policy for the coming years, estimates will change.

[6]Tax Policy Center (2010).

Figure 1. Tax Benefit From a Child, Current Law (2011) and Proposal to Create a Uniform Definition of Child, Single Parent, 1 Child



Note: Calculations assume all income is from earnings, that families have $3,000 in child care expenses for children 13 and under, and college students have tuition in excess of $4,000. Tax subsidies include dependent exemption, CTC, EITC, head of household filing status, and the CDCTC. Families with students 19 - 23 who do not count as qualifying relatives receive no benefits under the proposal.
Source: Urban-Brookings Tax Policy Center microsimulation model (version 0509-5).

How this change would affect families throughout the life cycle is unclear. Early research by Horowitz using the Survey of Income and Program Participation showed that almost half of people who begin receiving the EITC in any given year will not receive it the next year, and almost three-quarters of people only received the credit for two years or less.[7] More recent work by Horowitz and Dowd showed that more than 60 percent of families who claim the EITC do so for only one or two years at a time.[8]

The most recent work on EITC receipt over time uses panel data from the IRS for 2000 to 2006.[9] The data for those seven years show that children of recipients tend to be quite young. The average age of the oldest qualifying child in the household is well below college age (11.3 for one-time recipients, around 9 for longer-term recipients). Also, only 15 percent of recipient families received the EITC for four to six years; 30 percent of families received the EITC once in the seven years and another 32 percent received it for only two or three years. Thus, EITC qualifying children tend to be young, and families are unlikely to receive the benefit over the course of a child's entire postsecondary career.

Students whose families benefit from the EITC are less likely to attend college than others. As recently as 2004, only about half of students in the bottom income quintile enrolled in college immediately after high-school graduation,[10] calling into question even how broadly the student exemption

[7]Horowitz (2002).
[8]Horowitz and Dowd (2008).
[9]Ackerman et al. (2009).

[10]Goodman (2010).

applies for EITC eligible families. Therefore, the naïve estimate of weighing two additional years of CTC ($2,000 benefit) against five lost years of EITC ($3,050 in the extreme: having one child in college and no other children) seems a poor one. However, for a family with only one child who happens to be between 19 and 23 and is a student, even the loss of one year of the EITC could — if the household were eligible for close to the maximum amount — exceed the gains from the CTC from two prior years.

The vast majority of families will not receive the EITC for every year that their child is between the ages of 19 and 23 either because their incomes are too high once their children become students or because their incomes will be only temporarily low for a few years. Because only low- and lower-middle income families qualify for the EITC, only those families are at risk of being made worse off by the proposal than under current policy. The reduced EITC would save an estimated $3 billion in 2011. All savings come from low- and middle-income families who currently benefit from the EITC.

c. Dependent exemption. The change in tax liability from losing a dependent exemption for families with a 19- to 23-year-old college student can vary from a high of owing $1,295 to a low of owing nothing. Costs would be concentrated on higher-income families because of the tax code's progressive rate structure. Losing a dependent exemption would raise taxable income by $3,700 in 2011. For families in the highest tax bracket, that would mean a $1,295 increase in taxes. Families with no taxable income would see either no change in their tax liability from the loss of a dependent exemption or would have taxable income and would begin owing tax. Making ineligible for the dependent exemption all 19- to 23-year-olds who currently qualify for the dependent exemption would increase revenues by an estimated $4.5 billion in 2011.

That estimate grossly overstates the potential revenue gain, however, because some families whose older children currently qualify for the dependent exemption as children could qualify for the dependent exemption under rules for qualifying relatives — if the child's income falls below $3,700 in 2011. For those families, the proposal would effectively match current policy on the dependent exemption. That shift would reduce the proposal's revenue gain to an estimated $2.9 billion in 2011, concentrated among higher-income families.

d. Head of household filing status. The proposal would affect single parents in one other way. If a single parent's only qualifying child is a 19- to 23-year-old student, she would have to file as single under the proposal rather than as head of household. Singles typically have more of their income taxed at higher rates, because the brackets for singles are smaller than for heads of households. The exception here would be the same as the exception for the dependent exemption: A currently qualifying child may become a qualifying relative, resulting in no change between current policy and the proposal. The proposal's effect on head of household filing status would boost revenues by an estimated 1.1 billion in 2011, concentrated among higher-income families.

e. Combined effect. Only families with students ages 19 to 23 face the possibility of paying more taxes under the proposal. Families with children ages 17 to 18 would likely owe less tax, and the proposal would not affect families whose children are all under age 17 until the children are older. In essence, the proposal asks families with children to trade the almost certain prospect of gaining up to $2,000 for two additional years of CTC benefits at the risk of losing as much as $3,534 — the maximum EITC benefit for a worker with one child plus the tax savings from one dependent exemption — for each year the child would be a qualifying student.[11] But those lost benefits are far from certain. Children from families with incomes low enough to qualify for the EITC are less likely to attend college than their higher-income counterparts. Also, EITC receipt typically does not constitute a constant state for families, but instead a temporary state that does not extend over the student's entire college career.

2. Distributional analysis. How the proposal would affect families depends on how old their children are and how their incomes change. The distributional analysis does not account for lifetime changes, but does show the estimated change experienced in any given year, by income group. In 2011 I estimate the proposal would increase taxes for families with incomes less than $30,000 or more than $100,000, and decrease taxes for families with incomes between $30,000 and $100,000 (Table 3). The tax cuts that would be experienced by those with incomes between $30,000 and $100,000 are smaller than the savings that would be experience by the other two groups, resulting in net savings from the proposal. Those savings could be used to increase college subsidies for low-income families, which would target college assistance on families for whom it would likely have more influence.

[11]Single parents with one qualifying student and no other children will lose their maximum EITC of $3,094, and if they have income of $16,689 (the maximum income before the EITC begins to phase out), their taxable income will go from $4,789 to $9,189, which will be taxed at 10 percent. If the child continues to serve as a qualifying relative, their maximum loss would be $3,094 per year.

Table 3. Share of Change From Proposal to Create a Uniform Definition of Child Change Born by Various Income Classes (2011)

Cash Income	EITC	Dependent Exemption	Head of Household Filing Status	Any Tax Increase	CTC/Tax Cut
$0 - $10,000	12.4	0	0	5.3	1.2
$10,000 - $20,000	49.9	1.0	3.3	22.1	12.4
$20,000 - $30,000	26.6	3.6	8.6	14.1	15.7
$30,000 - $40,000	8.8	5.1	8.9	7.2	10.8
$40,000 - $50,000	1.3	7.0	8.8	4.8	12.2
$50,000 - $75,000	0	17.8	39.1	14.8	21.5
$75,000 - $100,000	0	21.8	22.8	13.8	17.6
$100,000 - $200,000	0	40.7	7.4	16.2	7.2
$200,000 - $500,000	0	1.7	0.7	0.8	0
$500,000 or more	0	1.3	0.4	0.6	0
Total change (in billions of dollars)	**$3.0**	**$2.9**	**$1.1**	**$7.0**	**-$6.1**

Source: Urban-Brookings Tax Policy Center microsimulation model (version 0509-5) and IRS.

a. Tax increases from the proposal. Of the proposal's total resulting tax increase, families with cash incomes less than $10,000 would bear 5 percent of the total increase, resulting exclusively from the loss of the EITC. Those families receive little to no benefit from the dependent exemption and head of household filing status because they typically do not have enough income to be taxed. The standard deduction and personal exemption often exceed the amount of income those families have that could be taxed. Families with cash incomes between $10,000 and $20,000 see some increase from the loss of a dependent exemption and head of household filing status, but most of the increase comes from the loss of the EITC. Overall, those families bear about 22 percent of the total tax increase. The proportion of the proposal's tax increase decreases with each subsequent income group and phases out for those with incomes between $50,000 and $75,000, because they receive fewer benefits from the EITC and still do not receive very large benefits from the dependent exemption and head of household filing status. Families with incomes between $50,000 and $75,000 would bear 14.8 percent of the cost increase from the proposal, driven by losses from head of household filing status and the dependent exemption. Families with incomes between $75,000 and $100,000 would bear 13.8 percent of the cost of the proposal for the same reasons. Most of the losses experienced by families in the highest-income groups would be a result of the loss of the dependent exemption, because very-high-income families (those with taxable income over $193,350) face the same tax rate regardless of whether they file as head of household or single. Understanding those distributional effects can help in designing higher subsidies for education that would maintain or improve overall progressivity.

b. Tax cuts from the proposal. All the proposal's tax cuts would be as a result of the increase in the CTC for families with children ages 17 and 18. The law would apply to those newly eligible children the same way it applies to currently eligible children; benefits from the proposal would be concentrated on families with incomes less than $75,000 (single parents) or $110,000 (married parents). At that point, the credit begins to phase out at a rate of 5 cents for each additional dollar of income. When the credit phases out completely depends on how many eligible children are in the family.

Families in the lowest income group ($0 to $10,000) would receive a very small share (1.2 percent) of the tax cut from the proposal because the credit is only available to families with earnings of at least $3,000. A little more than 50 percent of the benefits from the proposal would be delivered to families with incomes between $10,000 and $50,000. More than 21 percent of benefits would accrue to families with incomes between $50,000 and $75,000 (Table 3).

3. Making college aid transparent. One goal of reforming child-related incentives is to make them more transparent to taxpayers and easier for the IRS to administer. Changes also could pave the way for broader reform of child and worker credits. Modifying direct college assistance provisions so that they give more aid to low-income families — rather than extending them for all households — could both offset losses from limiting children's subsidies and help more lower-income students attend college.

Families are unlikely to consider the dependent exemption, EITC, and head of household filing status as significant incentives to attend college. True, those provisions leave parents of students with greater after-tax income than they would otherwise have, but many families will not recognize the connection between the provisions and college attendance. Those income gains may indirectly encourage some college enrollment, or enrollment in more expensive colleges, but they are unlikely to encourage college enrollment for marginal students who face barriers to college enrollment. Reschovsky (2008) found that education subsidies in the tax code do little to make higher education more affordable for low-income families; the lion's share of aid benefits students who would have attended college, even without the tax benefits.

Rather than creating an entirely new credit, policymakers could expand the AOTC to provide a higher base amount of assistance for low-income families, regardless of expenses, which could enhance the incentive of attending college for low-income families while offsetting losses from the unification proposal. The amount of aid could be set to make the full proposal deficit neutral, and policy design could focus aid on the lowest-income families — those least likely to attend college otherwise, most likely to respond to additional college incentives, and most at risk of losing the EITC. Alternatively, policymakers could use revenue gains to boost college aid through a system like Pell grants.

Eliminating the full-time student exception for the dependent exemption, head of household filing status, and the EITC, on the other hand, would strengthen tax code enforcement by removing an eligibility test the IRS cannot administer, absent a thorough audit. In the case of the EITC, dependent exemption, and head of household filing status, the qualifying child must both meet the expanded age limits (19 to 23) and attend college full time for five months of the year. Unlike provisions that are easily verified with Social Security and birth records, the college attendance test forces the IRS to administer a system for which it often has no immediately verifiable data. Unless an audit requires it, no third-party reporting is required to prove student status, making enforcement difficult. Data available to the IRS — college costs found on Form 1098T, ''Tuition Statement'' — are ill-suited to administering the full-time student status test. Those data do not indicate how many months a student attended school or whether that attendance was full time. Beyond that, the tax year and academic year differ, calling into question the tax year of attendance in even those cases in which some information exists. Removing 19- to 23-year-old students as qualifying children from those provisions would make the IRS's enforcement job much more straightforward.

E. Discussion

The national taxpayer advocate's annual report (2009) cited complexity as the number one issue facing taxpayers. Multiple age tests for defining children in the tax code clearly contribute to this complexity and create confusion. Parents must review separate instructions for each child-related provision rather than using a single comprehensive set. That complexity can lead to noncompliance if parents make the reasonable assumption that if a child qualifies for one benefit, then she also qualifies for other benefits. A system in which parents separately evaluate benefits for children under age 19, for college students, and for all other relatives would help them understand more readily which benefits they qualify for.

Different age limits for the CTC are difficult to justify. The Taxpayer Relief Act of 1997, which created the CTC, also introduced credits for subsidizing higher education — the HOPE credit (supplanted by the AOTC for 2009 through 2012) and the lifetime learning credit. Although some reformers argued at the time for integrating new child subsidies with the dependent exemption and/or EITC, that is not the path politicians chose. Budget constraints forced them to set the eligibility age for the CTC below that used in the EITC, dependent exemption, and head of household filing status, making the benefit distinct and complicating the definition of child.

Setting a single qualifying age for children could lead to a more comprehensive reform that would split and clarify child-related tax subsidies into one focused on children and one focused on work. Many proposals have called for replacing the multiple child incentives discussed here (exclusive of the CDCTC) as well as other credits sometimes applied to work (for example, the Making Work Pay credit from 2009-2010 and a Social Security tax offset for 2011-2012) with two separate provisions.[12] Those reform proposals typically have two goals: simplifying taxes and giving families a substantial wage supplement, whether or not they have children.

The political problem facing most reform proposals is that they either make many families worse off or reduce revenues substantially. A broad definition of children limits the number of losers but would raise the cost of extending the CTC to families with college students, as well as those with 17- and 18-year-old children. Alternately, a more restrictive definition of ''child,'' like that associated

[12]The Making Work Pay credit was enacted as part of the American Recovery and Reinvestment Act of 2009. For the years 2009 and 2010, it provided a tax credit equal to 6.2 percent of earnings, up to $400 for individuals — $800 for married couples. The credit phased out at higher earnings. For 2011, a Social Security tax offset was put in place which cut Social Security taxes by 2 percentage points.

with the CTC, would make a politically unacceptable number of families worse off.

In light of growing complexity in the tax system and increasing calls for separating work and child incentives, aligning the CTC rules with other related tax provisions seems a prudent and sensible step. Adopting the most generous definition — that contained in WFTRA — would cost too much, given our large budget deficits. Expanding the definition of a child to age 18 would mimic a common metric for childhood's end — the voting age — and also would match the age test for non-students with respect to the dependent exemption and head of household filing status. The choice of age 18 largely retains consistency with current law while being more responsible from a budgetary standpoint than an extension through age 23 would be.

Finally, subsidizing college through the dependent exemption, head of household filing status, and the EITC flies under the radar of most taxpayers and is therefore unlikely to do much to encourage college attendance.[13] Replacing the student exception with more effective college subsidies could strengthen both the tax code and the system of subsidies for higher education.

F. Summary

Families with children face a daunting array of tax policies that reduce their tax liabilities, relative to families without children. Although of monetary value to families, the complex structure of those incentives puts families at risk of not understanding the policies and hampers the IRS's ability to enforce the policies. As a result, some families who should benefit from the child provisions do not benefit, and others who should not benefit do.

Simplifying the definition of child by making age tests consistent across the major child provisions — the CTC, EITC, dependent exemption, and head of household filing status — would substantially help families with children. This article examines setting that age at 18, an age often thought to be the defining age of adulthood. That would extend the CTC to children ages 17 and 18, but students aged 19 to 23 would no longer count as children for the EITC, dependent exemption, and head of household filing status. Some families with students aged 19 to 23 (as many as 40 percent) would retain current policy benefits of the dependent exemption and head of household filing status because their child would shift from being a qualifying child to a qualifying relative.

Besides creating a simpler tax system that the IRS could administer more easily, the proposal would take a substantial step toward a broader reform that would separate, simplify, and better target worker and child incentives in the tax code. The cost of expanding the relatively generous benefits of the CTC to 19- to 23-year-old students would no longer impede further reform. Limiting child incentives to those under 19 would let reformers choose how to divide spending between child and worker benefits without regard to students who currently receive child benefits.

Rationalizing criteria for child benefits would likely save money: Higher revenues from the loss of the EITC, dependent exemption, and head of household status would exceed revenue losses from expanding the CTC. The additional revenues could be used to expand the AOTC (or Pell grants), targeting benefits to low-income students who are most likely to be influenced by additional incentives for college. The proposal would eliminate the college subsidies now hidden in the EITC, dependent exemption, and head of household filing status and thus allow the creation of transparent subsidies more likely to encourage college attendance.

A tax system with reduced complexity and increased visibility of tax incentives would provide two primary benefits: Taxpayers could better understand and react to incentives and the IRS could administer the provisions more effectively. The suggested reform builds on earlier work from WFTRA in creating a uniform definition of child and lays the foundation for additional, broader reform.

Mounting budget pressures may open the way to reforming child provisions in the tax code. Creating a more uniform definition of child might be a necessary precursor to a broader reform that separates tax incentives into those based on work and those based on children.[14] After all, the sticking points in many reform proposals are incurring either the costs associated with unifying the provisions at a higher age or creating many losers at a lower age.[15] Addressing that problem by first unifying the definition of child and simplifying education subsidies and then separating out work from child incentives could sustain a broader movement toward tax reform.

[13]Even the libertarian Cato Institute fails to include the EITC, standard deduction, and head of household filing status as subsidies for higher education (McCluskey and Edwards 2009). In President Obama's fiscal 2011 budget, the parental personal exemption for students age 19 or over is listed as an education tax expenditure, but head of household filing status for those parents and EITC payments are not included.

[14]*See, e.g.*, Cherry and Sawicky (2000); Progressive Tax Act (2003); Ellwood and Liebman (2001); Forman (2006); Carasso et al. (2008); National Taxpayer Advocate (2008); Bush Tax Reform Panel (2005); Berlin (2009).

[15]Carasso et al. (2008); Holt and Maag (2009).

Appendix

The Tax Policy Center (TPC) microsimulation model is well known for its ability to produce revenue and distribution tables from various proposals. The model is based on public-use data from the IRS Statistics of Income division. To maintain confidentiality, the public-use IRS data contain no information on the age of dependents. To analyze policies related to age, such as the one proposed here, TPC performs a statistical match with the Current Population Survey, which allows ages to be imputed onto the tax database. Although several factors are controlled for in the imputation process, it is nonetheless possible that the distribution of ages relative to income will not exactly match the actual distribution of ages. For example, while the total number of dependent exemptions in the TPC model will match the number in the actual IRS data, and overall will be distributed to the correct incomes, the total number of dependent exemptions taken for college students in some income classes must be estimated from nontax data on college students and may not match the actual tax data. Likewise, the TPC model will contain the correct number of children for purposes of calculating the EITC, but it has to estimate the number that are students between 19 and 23.

Also, the TPC model was not designed to handle the gross income test for a qualifying relative. Under current law, students are not subject to the gross income test but would be if they moved from qualifying child to qualifying relative. Because the tax model does not contain information on a student's gross income, it is not possible to determine which students would remain eligible for the dependent exemption and head of household filing status via the qualifying relative provision, if the policy were implemented to standardize the age of children at age 18 and under. Instead, the tax model will produce what could be considered an upper bound for the effect of that policy — although even that may not be true, depending on how students are distributed across incomes. The tax model could well under- or overestimate the policy's cost if the income and age variables were substantially off.

The TPC asked the IRS to produce tables showing the distribution of children by age and AGI. To estimate the effects of this proposal, I applied the average change for dependents in the relevant age group (19 to 23 for all but the CTC reform, which was 17 to 18) produced by the tax model, and then distributed it across the number of dependents the IRS data showed actually existed. To the extent that the TPC model produces a correct average, the estimates presented in this article will be correct. Errors in the average will carry through as errors in the estimates.

To account for the qualifying relative test, I used data from the National Postsecondary Student Aid Study to calculate what proportion of students, by AGI class, had income below the gross income test. That proportion of dependents in each AGI class was assumed to have no change in their tax liability as a result of the policy changes to the dependent exemption and head of household filing status. I applied the average tax change for 19- to 23-year-old dependents in the TPC tax model to the 19 to 23 year olds in the IRS data that likely did not pass the gross income test, thus reducing the savings from the proposal.

References

Ackerman et al., Deena, ''The Pattern of EITC Claims Over Time: A Panel Data Analysis,'' IRS Research Conference (2009).

Berlin, Gordon, ''Transforming the EITC to Reduce Poverty and Inequality: Policies for the 21st-Century Labor Market,'' *Pathways* (Winter 2009).

Carasso et al., Adam, ''The Next Stage in Social Policy: Encouraging Work and Family Formation Among Low-Income Men,'' The Urban Institute, Discussion Paper No. 28 (2008).

Cherry, Robert, and Max B. Sawicky, ''Giving Tax Credit Where Credit Is Due: A 'Universal Unified Child Credit' That Expands the EITC and Cuts Taxes for Working Families,'' Economic Policy Institute, Briefing Paper No. 91 (2000).

Dynarski, Susan, and Judith Scott-Clayton, ''College Grants on a Postcard: A Proposal for Simple and Predictable Federal Student Aid,'' the Hamilton Project, Discussion Paper 2007-01 (2007).

Ellwood, David T., and Jeffrey B. Liebman, ''The Middle-Class Parent Penalty: Child Benefits in the U.S. Tax Code,'' *Tax Pol'y and the Econ.*, Vol. 15 (2001).

Forman, Jonathan, *Making America Work* (2006).

Goodman, Joshua, ''Skills, Schools, and Credit Constraints: Evidence From Massachusetts,'' Columbia University, Department of Economics, Discussion Papers 0809-03 (2008).

Holt, Stephen D., and Elaine Maag, ''Considerations in Efforts to Restructure Refundable Work-Based Credits,'' Georgetown Center on Poverty, Inequality and Public Policy, Working Paper (2009).

Holtzblatt, Janet, and Janet McCubbin, ''Whose Child Is It Anyway? Simplifying the Definition of a Child,'' *Nat'l Tax J.* (Sept. 2003).

Horowitz, John B., ''Income Mobility and the Earned Income Tax Credit,'' *Econ. Inquiry* (July 2002).

Horowitz, John B., and Tim Dowd, ''The Earned Income Tax Credit: Short-Term Safety Net or Long-Term Income Support,'' presented at the 101st annual conference of the National Tax Association, Philadelphia (2008).

Progressive Tax Act of 2003, H.R. 3655 (2003).

IRS, ''A 'Qualifying Child,''' FS-2005-7 (2005).

IRS, Pub. 972, *Child Tax Credit* (2010).

IRS, Pub. 596, *Earned Income Credit* (2010).

IRS, Pub. 501, *Exemptions, Standard Deduction and Filing Information* (2010).

Maag, Elaine, ''Simplicity: Considerations in Designing a Unified Child Credit,'' *Nat'l Tax J.* (Dec. 2010).

Maag et al., Elaine, ''A Reference Manual for Child Tax Benefits,'' Urban-Brookings Tax Policy Center (forthcoming).

McCluskey, Neal, and Chris Edwards, ''Higher Education Subsidies,'' The Cato Institute (2009).

Mumford, Kevin, ''Child Benefits in the U.S. Federal Income Tax,'' Purdue Univ., Working Paper (2009).

Olson, Nina, ''2008 Annual Report to Congress,'' Office of the National Taxpayer Advocate (2008).

Olson, Nina, ''2009 Annual Report to Congress: Volume II: Research and Related Studies,'' Office of the National Taxpayer Advocate (2009).

President's Advisory Panel on Federal Tax Reform, ''Simple, Fair and Pro-Growth: Proposals to Fix America's Tax System'' (2005).

Reschovsky, Andrew, ''Higher Education Tax Policies,'' in *The Effectiveness of Student Aid Policies: What the Research Tells Us*, at 69-101 (2008).

Tax Policy Center, ''Remove the Child Tax Credit Distribution of Federal Tax Change by Cash Income Level, 2010,'' T10-0127 (2010), *Doc 2010-13250*, *2010 TNT 115-60*.