

Strengthening Family Tax Benefits in Massachusetts: An Analysis of State CTC Reform Options

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Issue Brief

Key Takeaways

- The state child tax credit (CTC) established last year in Massachusetts has been an effective tool for supporting families. Lawmakers in the state should build on its success by expanding it.
- The child tax credit is distributionally progressive, delivering a larger relative boost to lower-income families. It is also effective at reducing racial inequities.
- In addition to expanding the credit, lawmakers should consider removing the two-child cap on eligible children and allowing the full credit to be accessed by families regardless of whether the children are enrolled in paid-childcare arrangements.
- This brief presents several options for reform, detailing their likely distributional and budgetary impacts.

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In 2021, Massachusetts quietly converted two existing deductions for dependents into a pair of fully refundable child tax credits (CTC) as part of its [annual budget](#). Last month, Governor Charlie Baker proposed doubling these tax credits as part of the [fiscal year 2023 budget](#). This policy brief describes the proposed credits' anti-poverty, pro-work, and pro-marriage aspects. It also identifies two ways these credits penalize families, including larger families and families not paying for center-based child care. Finally, we offer several options for further improvements.

Background

Historically, Massachusetts families have been eligible for three primary tax benefits that help with the cost of raising children: a \$1,000 deduction for each dependent child as well as two tax benefits aimed at families with younger children. The first was a \$3,600 deduction for dependents under 12 years old. The second was a \$4,200 deduction for work-related child care expenses for children under 13 years old. Both deductions capped the number of eligible children at two per family. Families could claim either deduction - but not both - for each eligible dependent in any given year.

As deductions, one major limitation of both tax benefits is that families needed to earn a certain amount of income to qualify for a partial or full benefit. For example, a family earning \$10,800 per year or less would have been excluded from the benefits of these deductions altogether. Because other exemptions and deductions would wipe out any state income tax liability such low-income families had at tax time, the additional deduction was effectively worthless.

In contrast, fully refundable tax credits allow families to receive the full benefit of the credits regardless of income tax liability. Refundable child tax credits have been common in other wealthy democracies for decades, but they were absent in the United States until Congress temporarily enacted one as part of the [American Rescue Plan](#) of 2021. Its success and subsequent expiration this year has left many states exploring the possibility of enacting their own state-level refundable child tax credits.

Massachusetts became a leader in this effort when the legislature passed and the governor signed the 2021 budget. This converted the existing deductions for dependents under 12 and for work-related child care expenses into a pair of fully refundable tax credits – renamed the [Household Dependent Tax Credit \(HDTC\)](#) and the [Dependent Care Tax Credit \(DCTC\)](#), respectively. These credits keep several characteristics of the deductions they replaced, including eligibility requirements and a family cap limiting them to two children each, but effectively made each credit universal so that all families receive them regardless of income.

Figure 1:
Tax benefit structure before/after 2021 changes

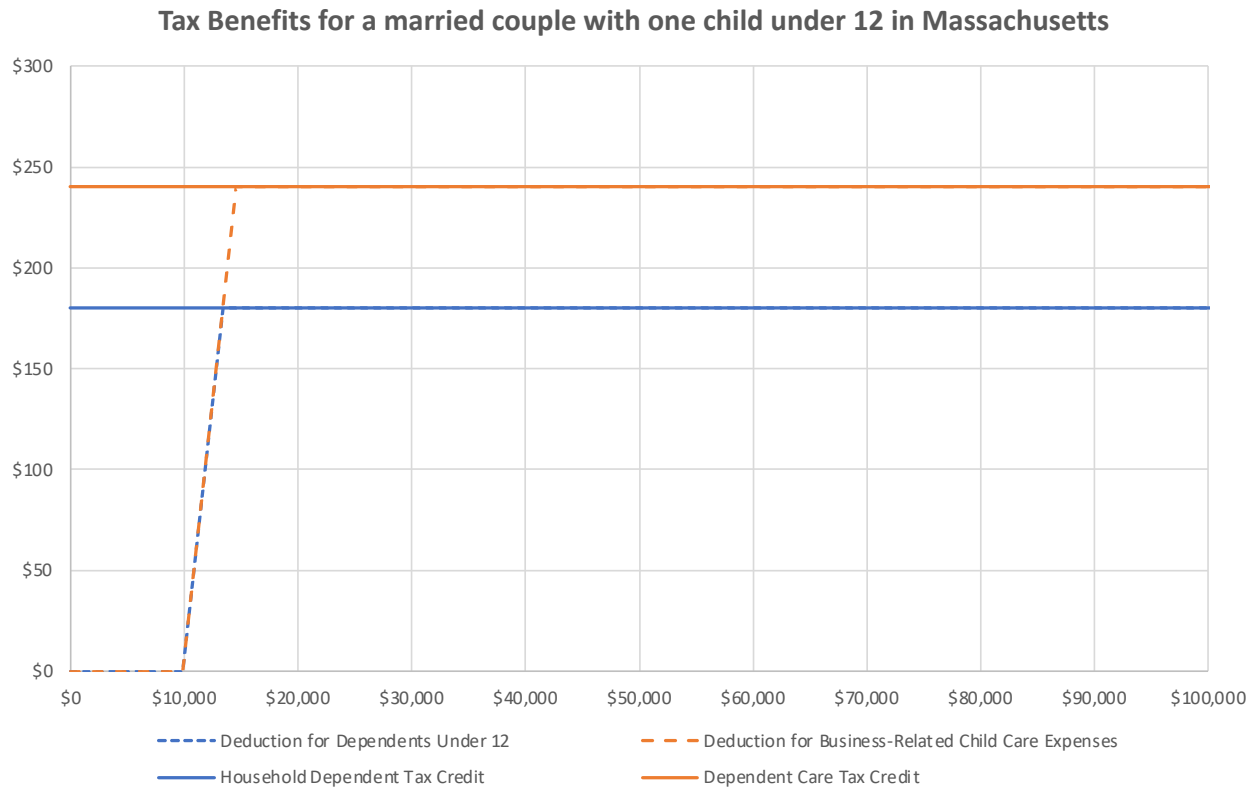


Table 1:
Massachusetts tax benefits for families

	Pre-2021 Budget		2021 Budget Changes	
Tax benefit	<i>Deduction for Dependents Under 12</i>	<i>Deduction for Work-Related Child Care</i>	<i>Household Dependent Tax Credit</i>	<i>Dependent Care Tax Credit</i>
Maximum age	11	12	11	12
Minimum income required for maximum benefit	\$9,000 for one child; \$13,600 for two children	\$10,200 for one child; \$16,000 for two children	\$0	\$0
Maximum benefit	\$180 for one child; \$360 for two children	\$240 for one child; \$480 for two children	\$180 for one child; \$360 for two children	\$240 for one child; \$480 for two children

Families in poverty (those earning less than \$26,500 for a family of four) were the primary beneficiaries of these changes. The current Baker proposal would build on last year's reform by doubling the value of the new credits while retaining the cap on the number of eligible children and the distinction between families that have eligible child care expenses and those that do not.

The case for refundable CTCs

Refundable child tax credits, like the HDTC and the DCTC, have several key features leading policymakers across the political spectrum to support their expansion. This includes important anti-poverty, pro-work, and pro-marriage effects.

Refundable CTCs are anti-poverty. Several studies (see [here](#) and [here](#)) have estimated the effects of recent changes to the federal child tax credit on low-income families. They find those changes reduced child poverty, particularly among Black and Hispanic families. Most recently, [Niskanen Center research](#) suggests that focusing on young children may be especially important for reducing family hardship. Because the HDTC and DCTC are fully refundable, they provide an income boost to all low-income families with young children.

Refundable CTCs are pro-work. Many welfare benefits, such as [TANF](#) and [SNAP](#), phase out with rising incomes, and this can create benefit cliffs or [high effective marginal tax rates](#) for families attempting to regain employment or move from part-time to full-time work. Some refundable tax credits, like the federal and state earned income tax credits (EITC), reduce these penalties for the lowest-income families but shift the problem to recipients further up the income scale. Because the HDTC and DCTC are universal, they do not penalize families as they move from welfare to work.

Refundable CTCs are pro-marriage. The same features of many welfare benefits and the EITC that create work penalties often similarly result in [marriage penalties](#). This occurs when income from marrying a partner would result in the loss of some benefits. Because the HDTC and DCTC are universal, there are no penalties associated with getting married to a working partner.

Limitations of the current and proposed HDTC and DCTC

Previous and proposed reforms are steps in the right direction, but the tax credits' existing structure leaves room for improvements. This includes two penalties that disadvantage certain family arrangements.

The HDTC/DCTC penalize larger families. Both tax credits limit the number of eligible children to a maximum of two per family. This penalizes families with three or more children. On average, married couples, as well as Black and Latino parents, are more likely to have larger families. One option for removing this penalty is to lift the cap on the number of eligible children.

The HDTC/DCTC penalizes families for not using and paying for center-based care. Families claiming the DCTC can receive up to 25 percent more than families receiving the HDTC if they have qualified child care expenses. This penalizes families who rely on traditional arrangements, such as stay-at-home parents and extended family members, as well as lower-income families who may be using care arrangements that are free at point of service. One option for removing this penalty is to consolidate the two distinct credits into one child tax credit worth the more generous amount.

The impact of HDTC/DCTC options on Massachusetts families

In light of the expiration of the CTC expansion at the federal level, the proposed expansion of the HDTC and DCTC would benefit from state-level estimates of the economic effects on families in the Commonwealth. Assessing the impact of Massachusetts' tax credits is particularly important as [several other states](#) recently introduced Massachusetts-style refundable child tax credits or are [actively considering](#) the idea.

We estimate¹ the impact of the current law as well as four policy reforms (see Table 2) meant to address the penalties discussed above:

- **Baker Proposal** doubles the maximum value of the current HDTC and DCTC without changing any other eligibility requirements.
- **Baker Proposal, Uncapped** doubles the maximum value of the current HDTC and DCTC and removes the cap on the number of eligible children.
- **Baker Proposal, Equalized** consolidates the HDTC and DCTC into one single tax credit worth \$480 (double the maximum value of the current DCTC) for the first two children under 13 and drops the qualified-expenses requirement.
- **Baker Proposal, Universal** consolidates the HDTC and DCTC into one single tax credit worth \$480 (double the maximum value of the current DCTC) for all children under 13 and drops the qualified-expenses requirement and cap on number of eligible children.

Relative to current law, households with age-eligible children would see child benefits double on average under the Baker proposal, growing from \$266 to \$532. Removing the two-child cap yields an additional boost. Under this reform, families with three or more children under the age of 13 would receive an average credit of \$573. Removing the current paid child care requirement and making all families eligible for the higher maximum credit while capping it at two kids further increases the average total benefit for households with children to \$711. Lastly, removing the two-child cap and upwardly equalizing the credits brings the average total among households with children up to \$781.

The proposed benefits flow disproportionately to households that are more likely to have young children and less likely to be using paid child care arrangements. On average, nonwhite households would see the highest gains under all the proposed reforms. The differences in potential gains across race and ethnicity cannot be chalked up to income levels, because as a universal program these credits go to all families with eligible children. Instead, the differences are overwhelmingly driven by demographic factors – average household age and family size. Hispanic households benefit the most as they tend to have [larger families](#) with [younger](#) children. Proposals that remove the two-child cap

1 Estimates of the various policies were constructed using the 2019 American Community Survey (ACS) with additional variables, such as the utilization of paid child care arrangements, constructed based on imputations from the Current Population Survey (CPS). In order to more accurately reflect the most up-to-date scenario, the data was aged based on more current estimates of the Massachusetts state population.

on household benefits are thus particularly beneficial for these families.

The impact of refundable tax credits like the HDTC and DCTC is progressive, as benefits increase household incomes by larger proportions in the lower quintiles. Because child benefits are targeted

Table 2:
Policy parameters under current law and reform proposals

Policy option	Current Law		Baker Proposal		Baker Proposal, Uncapped		Baker Proposal, Equalized	Baker Proposal, Universal
	HDTC	DCTC	HDTC	DCTC	HDTC	DCTC	Consolidated CTC	Consolidated CTC
Max. age	11	12	11	12	11	12	12	12
Family Cap	2	2	2	2	No cap	No cap	2	No cap
Qualified expense req.	No	Yes	No	Yes	No	Yes	No	No
Max. benefit per child	\$180	\$240	\$360	\$480	\$360	\$480	\$480	\$480

Figure 2:
Average household benefit for families with age-eligible children

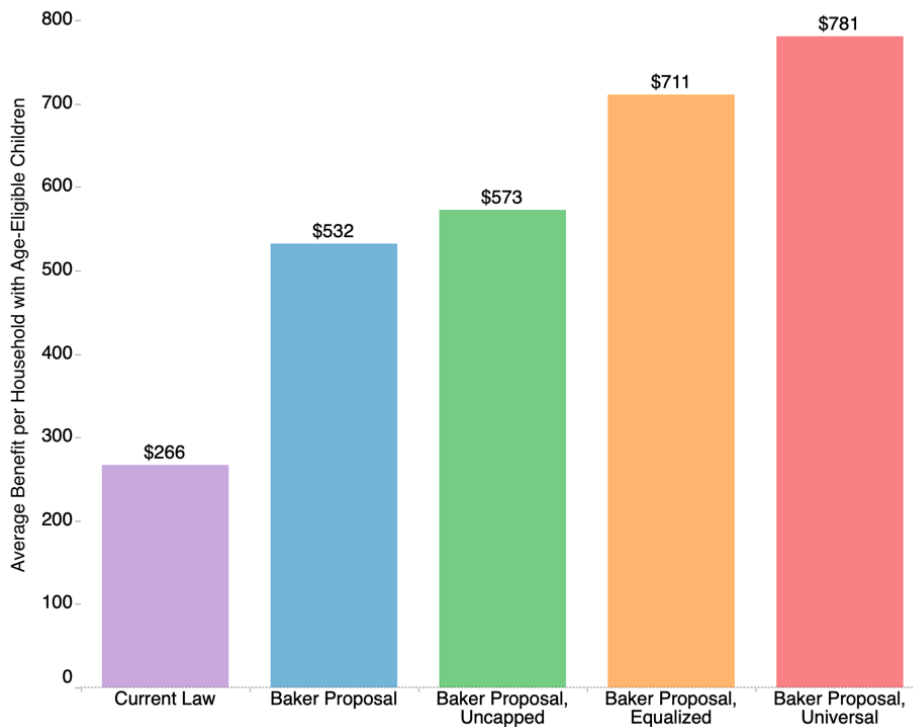
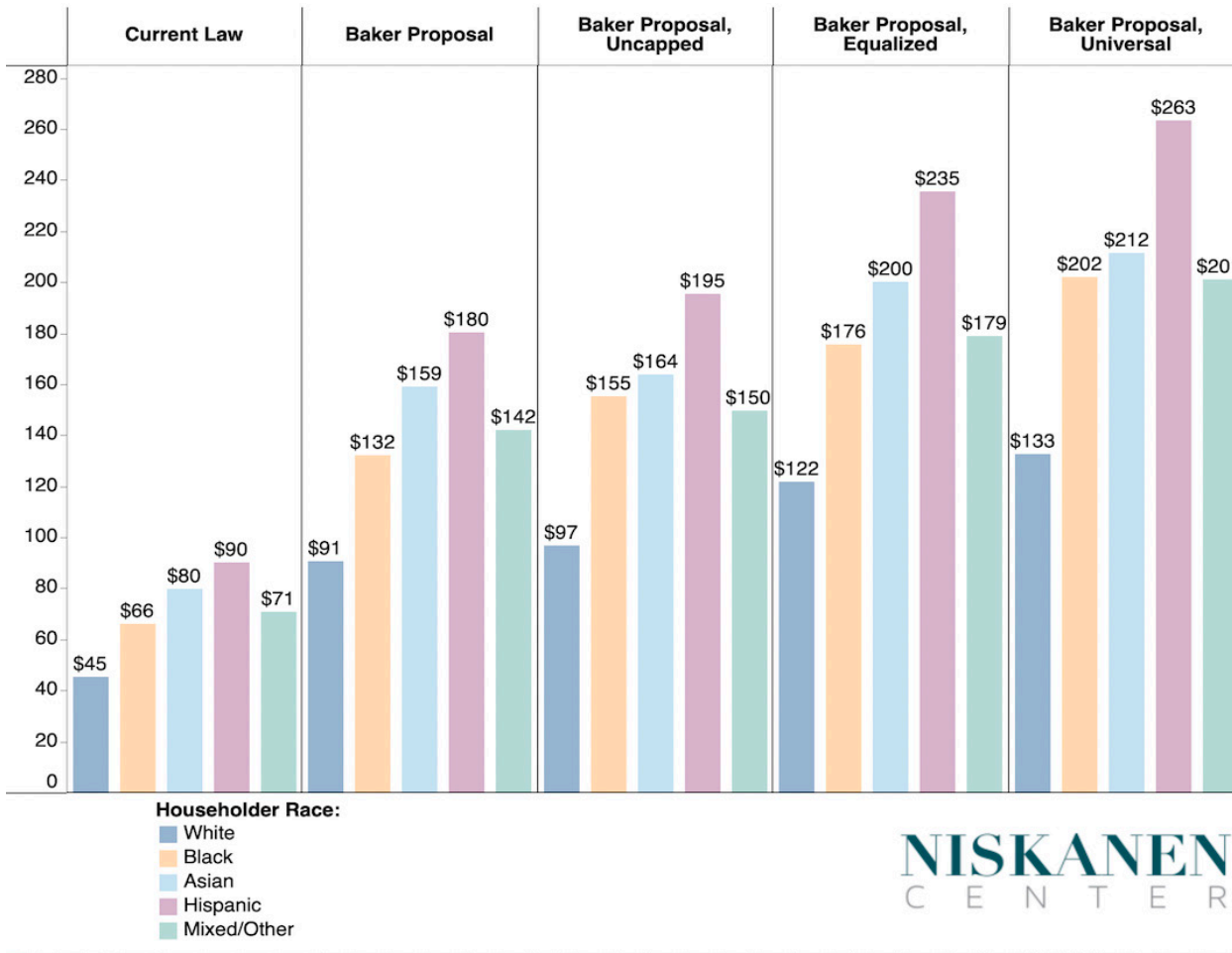


Figure 3:
Average household benefit for all households by race/ethnicity



larger benefits deliver correspondingly larger relative boosts in overall income to lower-income households. Targeting child benefits at children aged 12 and younger increases progressivity. Parents of younger children also typically have lower earnings themselves, meaning that targeting of credits at children.

Indeed, because households with negative or zero income were omitted to make the calculation tractable, Figure 4 understates the progressive impact of the boost that lower-income families receive under larger HDTC/DCTC expansions. The relative gain to lower-income households would be even larger if the analysis was restricted merely to households with children. The most expansive reform proposal would boost the income of the lowest-earning household by 2.8 percent while only raising the income of the highest-earning households by about one-tenth of a percent.

The cost of the various policy options increases predictably with the size of the benefits, ranging from \$163 million annually under current policy to \$473 million under the universal version of the Baker proposal. Relative to the baseline cost of the Baker proposal, eliminating the two-child cap would add \$25 million. Consolidating/equalizing these benefits would add \$106 million, and removing both penalties (no cap, consolidated/equalized benefit) would add \$148 million to the total cost of expansion.

Figure 4:
Average benefit as a percent of income by quintile

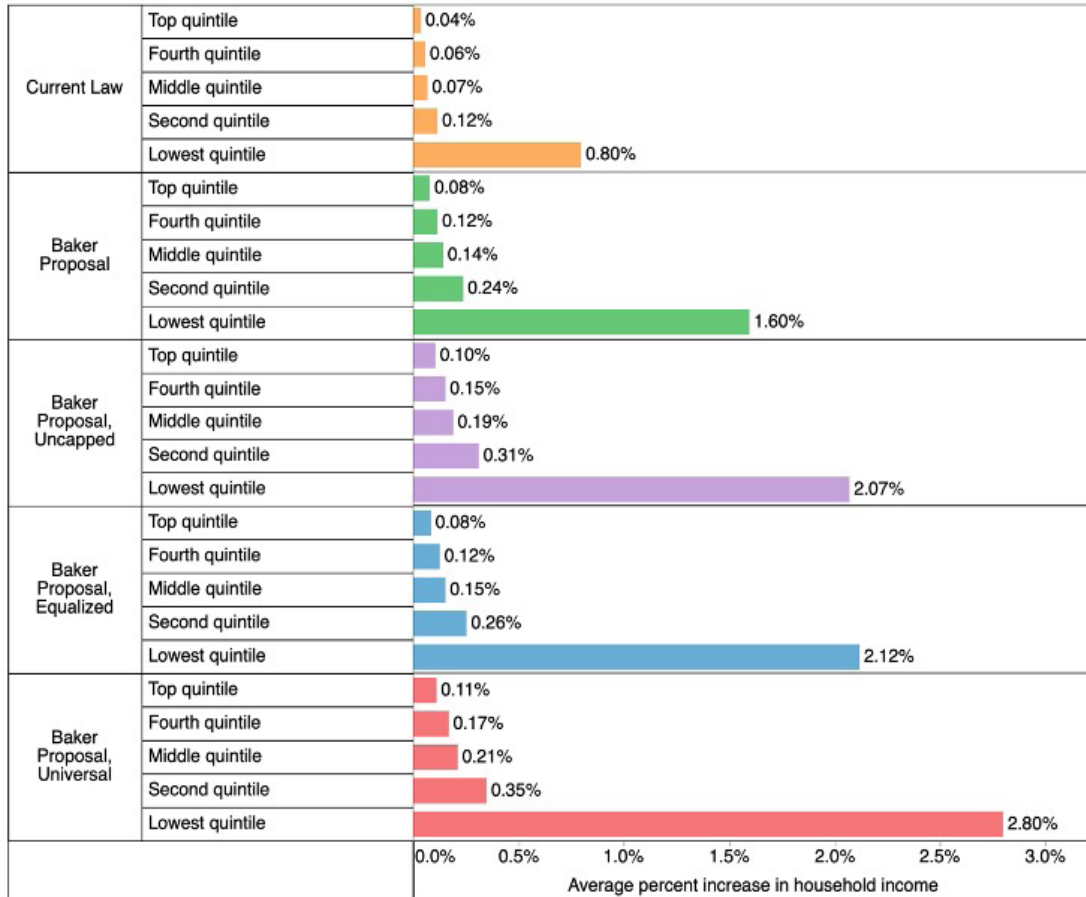
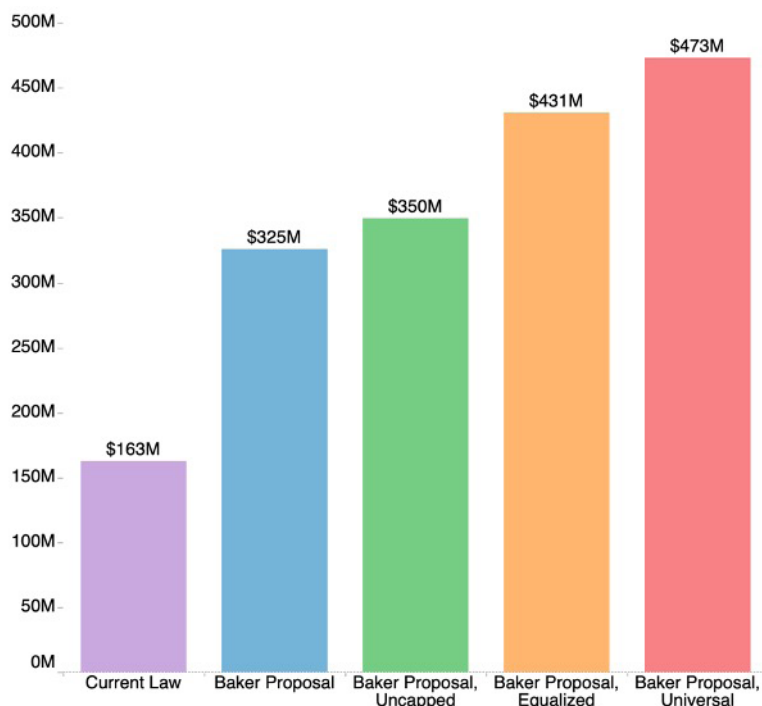


Figure 5
Estimated cost of each reform proposal



To put this into perspective, the total cost of the Baker administration's entire tax reform package amounts to almost \$700 million. The entire operating budget amounts to \$48.5 billion. Expansion beyond the initial Baker proposal would come at relatively small costs relative to the potential benefits of eliminating penalties for families that have more children or are not paying for center-based child care.

Conclusion

Last year's reform and the current Baker proposal helped families struggling with rising costs. Both sets of proposals reduce poverty and don't penalize parents for their hard work or for getting married.

But larger families and families not paying for center-based care are still penalized for their choices. The Baker proposal requires further adjustment to boost benefits for all households. Several affordable reforms would address these issues in a progressive manner and advance racial equity.

Massachusetts has the chance to solidify its reputation as a leader in pro-family policy. We hope the legislature and Baker administration take the necessary steps to address these issues so the Commonwealth continues to be seen as one of the best places in the nation to raise a family.

About the Authors

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Robert Orr is a policy analyst at the Niskanen Center. He previously worked at the Cato Institute, and as a graduate research fellow for the Mercatus Center at George Mason University. Orr's work has been featured in several prominent outlets such as the Atlantic, Vox, the Washington Post and more. His research focuses on welfare, health care, and labor market policy.

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Joshua McCabe is an expert on tax and social policy and author of *The Fiscalization of Social Policy: How Taxpayers Trumped Children in the Fight Against Child Poverty* (Oxford University Press).

McCabe has previously contributed to the Niskanen Center in support of our work on cash-based solutions to child poverty and household stability, with an eye to the ultimate goal of a fully refundable child allowance. Additionally, McCabe's thoughts on the comparative health systems of the U.S. and Canada provides a fresh perspective on trade-offs associated with popular "Medicare for All" proposals, and suggests a path forward for universal health insurance delivered at the state level.

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