Data Spotlight:

Tax Credits and Building Economic Mobility for Youth

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Family & Community | Health | Economic Well-Being | Education

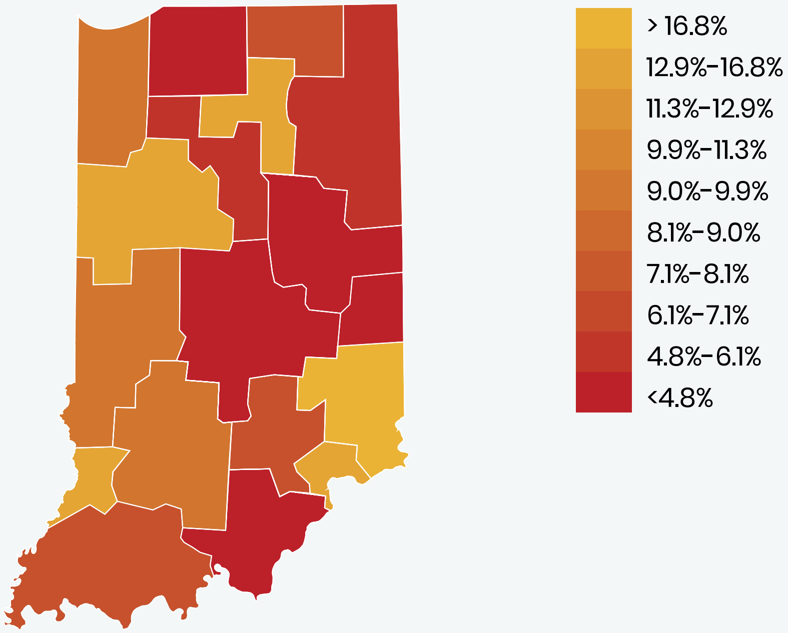
Economic Mobility in Indiana

Economic mobility is defined as the ability of an individual to improve their economic status. This is often measured by whether a person can do better economically than their parents. It is based on the odds of a child from the bottom 20% of the income bracket reaching the top 20%. In essence, it measures the attainment of the American Dream. Mobility rates are relatively low in areas with high income inequality and racial segregation.[1] While children in higher-income households tend to not be impacted by location, geography matters for children growing up in poverty.

Throughout Indiana and across the country, being raised in poverty significantly affects the chance of achieving the American Dream. Children raised in poverty in Indiana have a limited chance of earning a median income equal to their peers from higher-income families. For Hoosier children who grew up in poverty in urban or rural counties, they earned a median income less than children who grew up in poverty in suburban counties.[2] Place, especially the effect of neighborhoods, has an influence on a child's economic mobility. Every year that a child spends in a disadvantaged neighborhood has an incrementally negative effect on their outcomes as adults, regardless of their race, income, or other demographic characteristics.[3] Understanding wealth is important to fully comprehend economic mobility in the United States, especially the effect of wealth on economic mobility across generations.

Economic mobility is especially low in Indiana's cities, such as Indianapolis. In a ranking of intergenerational mobility, of the 50 largest Commuting Zones in the U.S., Indianapolis ranked 46th, indicating that children born in this city have low rates of economic mobility compared to their peers in other urban areas.

Children's Chances of Reaching Top 20% of Income Distribution by County, Indiana: 2017



Source: The Equality of Opportunity Project
Note: Upward mobility is measured by the fraction of children who reach the top fifth of the national income distribution, conditional on having parents in the bottom fifth. Lighter colors represent areas with higher levels of upward mobility.

Additional Resources on Econmoic Mobility

- To learn more about economic mobility by neighborhood, please visit this **interactive map**.
- To learn more about Indiana's wealth gap, check out IYI's **Data Report: Indiana's Wealth Gap**.

Family assets strongly correlate with indicators of child well-being, such as academic performance and self-esteem, and help children avoid negative consequences, such as behavioral problems and teenage pregnancy.[4] Building wealth and assets to make investments in children is fundamental for families, communities, and the U.S. economy. It is also critical to a child's potential economic mobility. This Spotlight will examine policies that are research-based strategies to building wealth and assets for children. They are intentional on-ramps to opportunities and mobility to break intergenerational cycles of poverty.

Economic mobility is especially low in Indiana's cities, such as Indianapolis. In a ranking of intergenerational mobility, of the 50 largest Commuting Zones in the US, Indianapolis ranked 46th, indicating that children born in this city have low rates of economic mobility compared to their peers in other urban areas.[5]

- The lowest income children in Indianapolis have a 4.9% chance of progressing to the top 20% income bracket.
- For children of color in Indianapolis, that percentage is nearly cut in half.[6]
  - In 2021, Black children born to low-income families in Indianapolis grew up to earn $9,000 less than White children born to low-income families.
  - Black families with children earned $22,000 per year on average compared to White families with children ($31,000).
  - Black boys born to high-income parents in Indianapolis are half as likely to have high incomes in adulthood compared to White boys and twice as likely to have low incomes.
  - Economic mobility for low-income White children in Indianapolis ranks last among the 50 largest cities.[7]
- The opportunity gap between children born to high-income and low-income families is larger in Indianapolis than in 88% of other large cities.
- In Indianapolis, children of low-income families earn 46 cents for every dollar earned by children of high-income families. The average city's rate is 38 cents.[8]

Asset Building Policies

Child Tax Credit: On July 15, 2021, about 39 million families with children began receiving monthly payments from the expanded Child Tax Credit (CTC). In March 2021, Congress passed the American Rescue Plan Act, which expanded eligibility for the CTC, increased the amount, and made it fully refundable. This means that eligible families can now receive the full CTC, even if they do not have earned income or owe any income taxes. Estimates suggest that the expanded CTC will increase the CTC amount for 65 million children, reduce the level of children living in poverty in the United States from roughly 12.5% of children to 8%, and eliminate large disparities in CTC amounts by income and race/ethnicity.[9]

Under the changes to the CTC, most children in families with incomes in the bottom decile of the national income distribution are newly eligible for the full CTC. Under the previous provisions for the CTC, though incomes of most families with children increased, benefits tended to be smaller for the poorest families with children. Because the credit amount gradually phased in for lower-income families, they were less likely to receive the CTC than moderate- and some higher-income families and tended to receive a smaller credit. Under the prior CTC regulations, 90% of all taxpayers with children received the CTC, averaging $2,370 per taxpayer. In contrast, among the poorest families with children with incomes under $10,000, 47.8% of families received the credit, averaging $250 per taxpayer in that income group.[10]

Under the American Rescue Plan, the maximum CTC in 2021 was increased to $3,600 for children under the age of 6 and up to $3,000 per child for children ages 6 to 17. Additionally, the credit is fully refundable for 2021, meaning eligible families can get it even if they do not have earned income or owe any income taxes. The new maximum CTC was available to eligible families with a modified adjusted gross income of:

- $75,000 or less for singles;
- $112,500 or less for heads of household;
- $150,000 or less for married couples filing a joint return; and
- Above these income thresholds, the amount above the original $2,000 credit (either $1,000 or $1,600 per child) was reduced by $50 for every $1,000 increase.[11]

The CTC has been shown to reduce child poverty and increase potential economic mobility. A National Academy of Sciences panel on child poverty concluded that the two refundable tax credits (the Earned-Income Tax Credit (EITC) and the refundable portion of the CTC) have been the most successful policies at reducing child poverty. Poverty alleviation can promote child development, both because of the goods and services that parents can buy for their children and because it may create a more responsive, less stressful environment for positive parent-child interactions.[12] Other benefits from CTC for youth include:

- The credits have led to improvements in infant health, maternal health, children's cognitive outcomes, and educational attainment.
- These tax credits have led to substantial increases in employment for single mothers, especially among those with less than a college education and with more than one child.[13]
- A $1,000 tax credit was shown to correlate with a 6% to 9% standard deviation improvement in a child's standardized test score. An effective teacher's impact on achievement is approximately 10% improvement in a standard deviation in test scores, thus, the CTC can potentially help close the achievement gaps among youth subgroups (e.g., racial/ethnic minorities, low-income, and disabilities).[14]
- Poverty reduction programs similar to CTC have been shown to have a causal impact on early childhood brain activity. Early childhood poverty is a risk factor for lower school achievement, reduced earnings, and poorer health. It has been associated with differences in brain structure and function. Whether poverty causes differences in neurodevelopment or is merely associated with factors that cause such differences remains unclear. The Baby's First Years study showed that a predictable, monthly unconditional cash transfer given to low-income families positively changed infant brain activity. Low-income babies in families receiving the cash transfer saw improved neuroplasticity and environmental adaptation. These changes displayed a pattern that has been associated with the development of subsequent cognitive skills.[15]
- The CTC helps offset the cost of childcare for many low-income, working families. Care expenses can include daycare costs, preschool, day camp, and before- and after-school care for older children. The tangential benefits of assisting with childcare costs includes increasing mothers' participation in the workforce and allowing for spending on other necessities, such as food and housing.[16]
- These benefits indirectly influence a child's wealth accumulation by reducing hardships in poverty and promoting educational attainment. For children of racial/ethnic minorities, educational attainment may not close the wealth gap, but it does increase potential wealth earnings. For more information, please see the **Factors of Wealth** section further on.

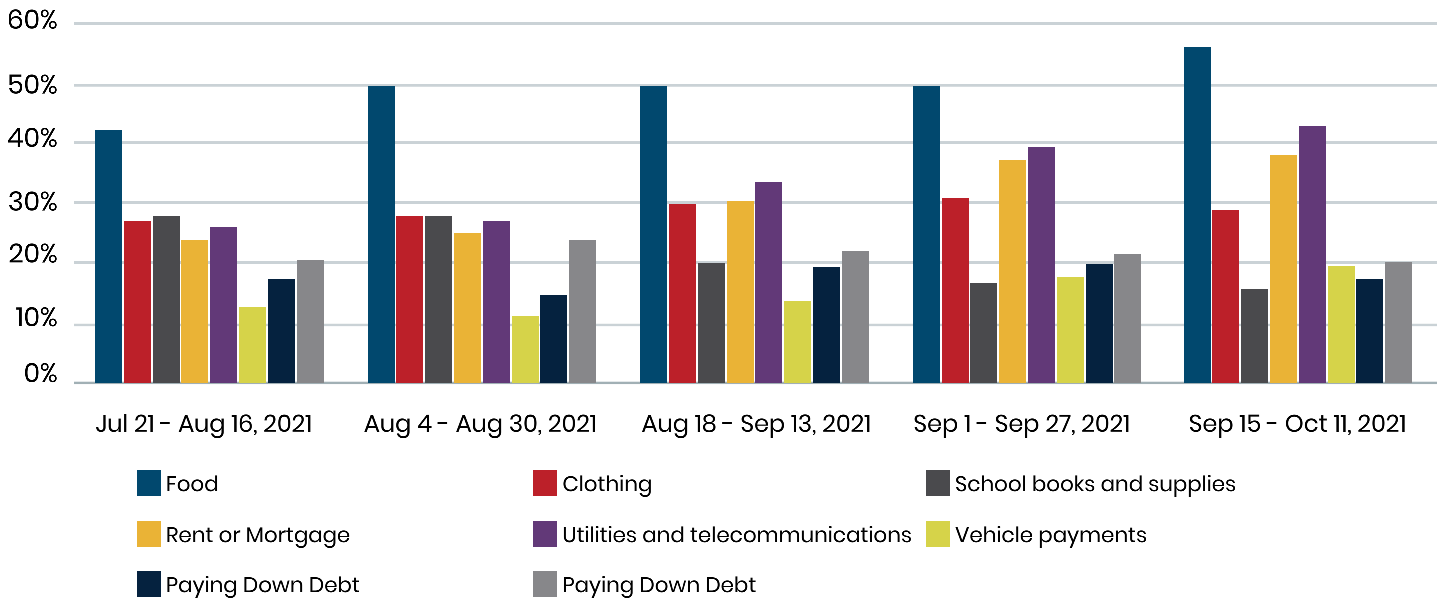
The final expanded CTC payment went out in December 2021. Nationally, more than 60% of households with incomes below $35K applied the CTC to meet spending needs. Most CTC recipients across the U.S. were employed and used the payments to supplement their regular income.[17]

- As of December 2021, 66% of Indiana households with children reported receiving a CTC payment in the past four weeks, which was slightly higher than the national rate of 59% of households with children.[18]
- 760,000 CTC payments were issued in Indiana to 1,333,000 Hoosier children in December 2021.
- The total amount distributed in Indiana between July and December was slightly over $2 billion.
- The average payment in December was $458, which was higher than the national amount of $444.[19]
- Indiana families in the highest income category (over $100,000) were most likely to receive the CTC at 77.5% in receipt. Families making less than $50,000 had the lowest reported receipt percentage at 58.3%.[20]

Based on Household Pulse Survey respondents from December 2021, most Hoosier families (43%) reported using their CTC payment to pay down debt. 42% of Hoosier families reported spending their CTC payment, and 15% of families reported saving it.[21]

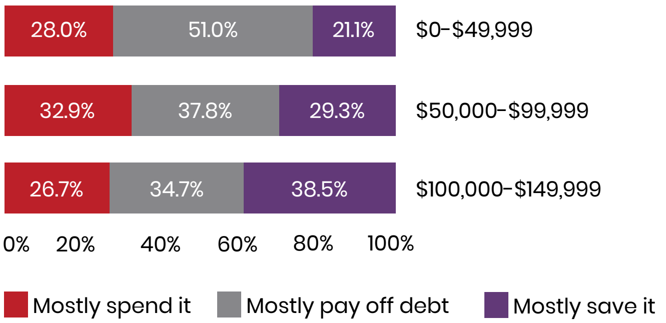
- Families in the lowest income category were more likely to use their CTC funds to pay down debt relative to other groups, while those in the highest income category were more likely to report saving their CTC payments.[22]
- Of Hoosier families who spent their CTC payment, the most common use of the CTC payment was for food. Following food, CTC payments were spent on rent or mortgage and utilities and telecommunications.[23]

Percentage of CTC Spent by Types of Spending, Indiana: July 21,2021 - October 11, 2021



Source: U.S. Household Pulse Survey

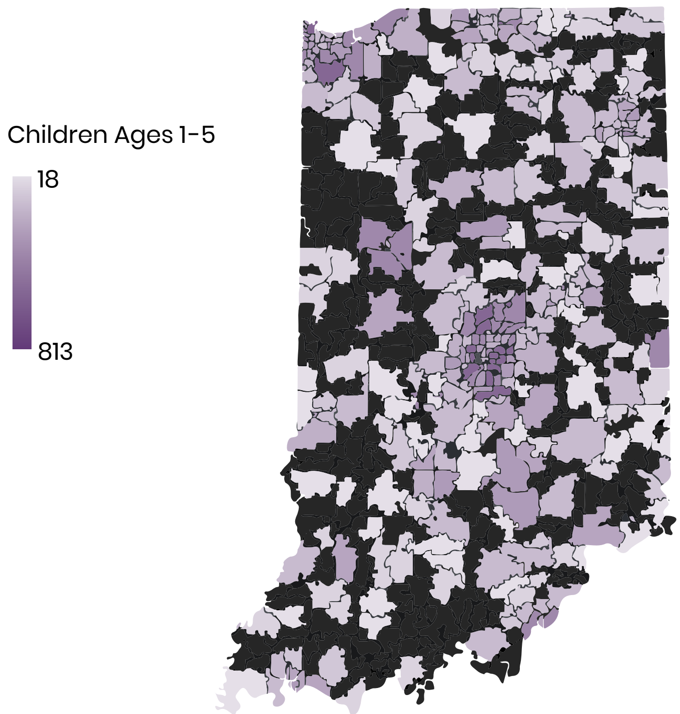
Percentage of How CTC Was Used by Income, Indiana: 2021



Source: Washington University

Based on 2019 tax filings, about 41,000 children under 18 were listed on the health insurance tax form (Form 1095) but were not counted for the CTC. The Treasury Department compared existing filing units with Form 1095 tax information, which lists children who have health insurance (including coverage through Medicaid or CHIP), to identify children whom no adult claimed on a tax return but who have health coverage.[24] These are children throughout the state whose families are not benefitting from the CTC program. Likely, these are some of the most vulnerable children in Indiana and for whom the positive outcomes of CTC access could have the greatest impact.

Estimated Counts of Children Not Claimed by Child Credit but Found on Health Insurance Tax Form by Zip Code, Indiana: 2019



Source: U.S. Treasury Department

In December 2021, 760,000 CTC payments were issued to 1.3 million Hoosier children. The total amount distributed in Indiana between July and December was slightly over $2 billion.

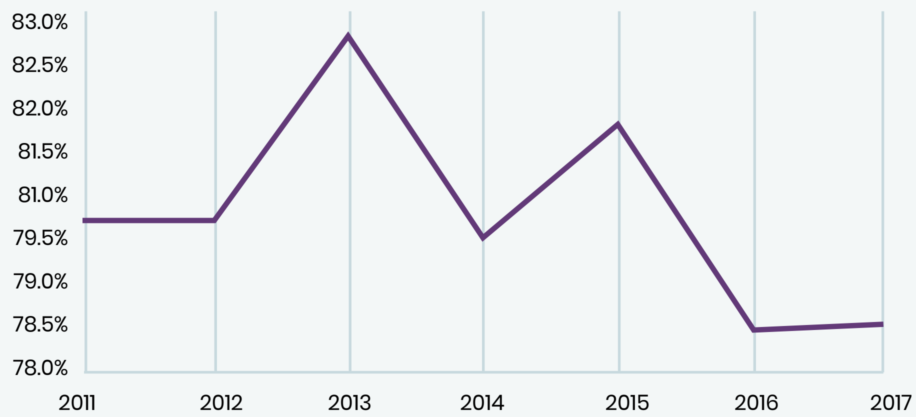
Earned Income Tax Credit: Since the Earned Income Tax Credit (EITC) was added to the U.S. tax code almost 50 years ago, it has become the leading federal program for boosting the incomes of the working poor. Traditional cash aid policies did little to encourage recipients to join the workforce and change their socioeconomic status. But by virtue of being directly tied to earnings, the EITC essentially subsidizes, and therefore encourages, work. The program provides refundable tax credits to low-income workers, raising the effective wage a person earns in the labor market. Because it targets low-income families, it is effective at reducing poverty, both through direct income transfers and work incentives. In particular, the EITC has shown significant positive impact on low-skilled single parents.[25]

Income thresholds for eligibility vary based on marital status and number of qualifying children, and the refund depends on a recipient's earned income, number of qualifying children a taxpayer has, and the taxpayer's marital status. For 2020, the maximum EITC for a taxpayer with one child was $3,584 per year; for two children, $5,920 per year; and for three or more children, $6,660 per year.[26] Indiana is one of 25 states that offers a state supplement to the federal EITC. The state's Earned Income Tax Credit provides up to 9% of the earned income credit claimed on the federal income tax return.[27]

- In 2020, 515,000 Hoosier families received a refund through the federal EITC for a total of $1.2 billion.
- Indiana families received an average $2,403 EITC refund, which was slightly lower than the national average of $2,461.[28]
- Indiana's participation rate between 2011 and 2017 (the most recently released participation rate data) has oscillated between 79.5% and 82.8%.[29]
- Indiana is one of 24 states to offer a State EITC. Indiana's State EITC is a refundable tax credit. If a refundable credit exceeds a taxpayer's state income tax, the taxpayer receives the excess amount as a payment from the state. Indiana's State EITC as 10% of the federal EITC.[30]

Based on national findings, the EITC increases low-income families' position in the wealth distribution. A $1,000 EITC refund when the child is up to five years old is associated with around a $2,900 (6.1%) increase in total household wealth among families where the head of household has a high school education or less and a $3,270 (5.2%) increase among household heads with less than a college education. There was no significant effect among households with a college degree or more. The effects, however, are concentrated among White families. Thus, the EITC does increase family wealth in childhood, but it may not do much to reduce the racial wealth gap long-term.[31]

EITC Participation Rate, Indiana: 2011-2017



Source: U.S. Internal Revenue Service

Locally:

- **Assist non-filers with signing up for CTC:** While most children in the U.S. are in families that will get advance CTC payments automatically, some children are in families that are considered non-filers and will need assistance signing up. Non-filers are often not required to file taxes but are eligible for the CTC. This may include families who:
  - Have very low to no income; many earn less than $2,500
  - Have limited internet and technology access
  - Participate in SNAP or TANF

  The two primary goals for CTC outreach include raising awareness and helping non-filers receive payments using **GetCTC.org** to sign up for payments. Additionally, connecting various community resources (e.g., tax volunteers known as VITAs and community action agencies) and places with direct access to children and families (such as schools or faith-based organizations) may increase outreach. Identifying local resources and determining various organization's roles and capacities will help connect non-filers with additional support and information.[32]

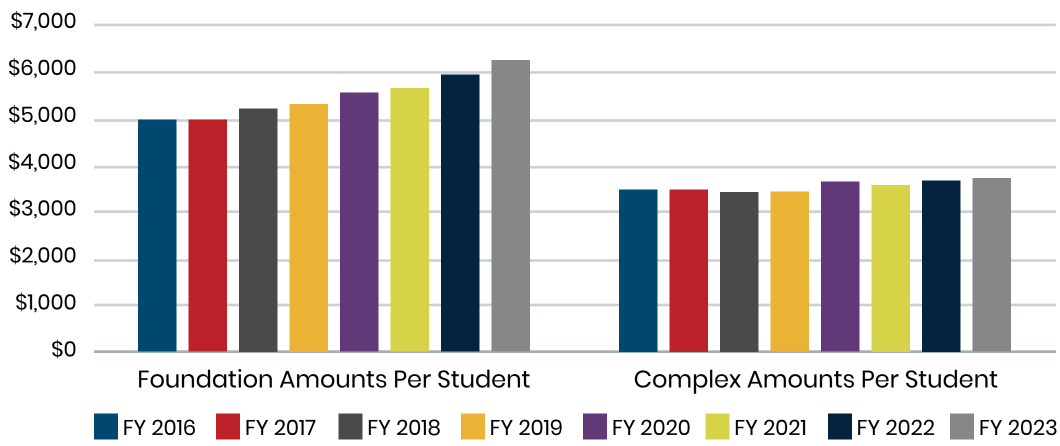
Promising Practice:

The Mayor of Fort Wayne partnered with local financial institutions and other dedicated local, community-based organizations to assist lower income working families to apply for tax refunds, specifically the EITC. This collaboration in the community throughout Fort Wayne assisted low-income families file the paperwork necessary to claim the credit.[33]

Statewide:

- **Examine the Complexity Index for school funding:** Over the past 3 budget cycles, the Indiana General Assembly has slowly shifted more towards Foundation Grants to equalize the distribution of funding. While this has increased funding for all students across Indiana, the approach has also limited additional resources directed at students facing greater opportunity gaps than their peers due to where they live (e.g., urban or rural areas) or barriers to success because of their backgrounds (e.g., low-income). In preparation for the 2023 Legislative Session that will determine the budget for Fiscal Years 2024 and 2025, the State could quantify the costs of providing additional resources based on student need through an examination of the Foundation Grants and Complexity Index. Studying the necessary costs to close educational outcome gaps, as well as additional metrics for defining poverty (such as Texas' approach), could provide an economic understanding of how to equalize the differences in school expenditure across the State. School finance equalization – the reduction in the differences in public school revenues and expenditures across school districts within a state – can increase intergenerational mobility through a reduction in the gaps in basic school inputs (such as the number of teachers) and in intermediate educational outcomes (such as college enrollment) between richer and poorer districts. It also helps reduce income and racial segregation between school districts.[34]

Foundation Amounts and Complexity Amounts per Student, Indiana: 2016-2023



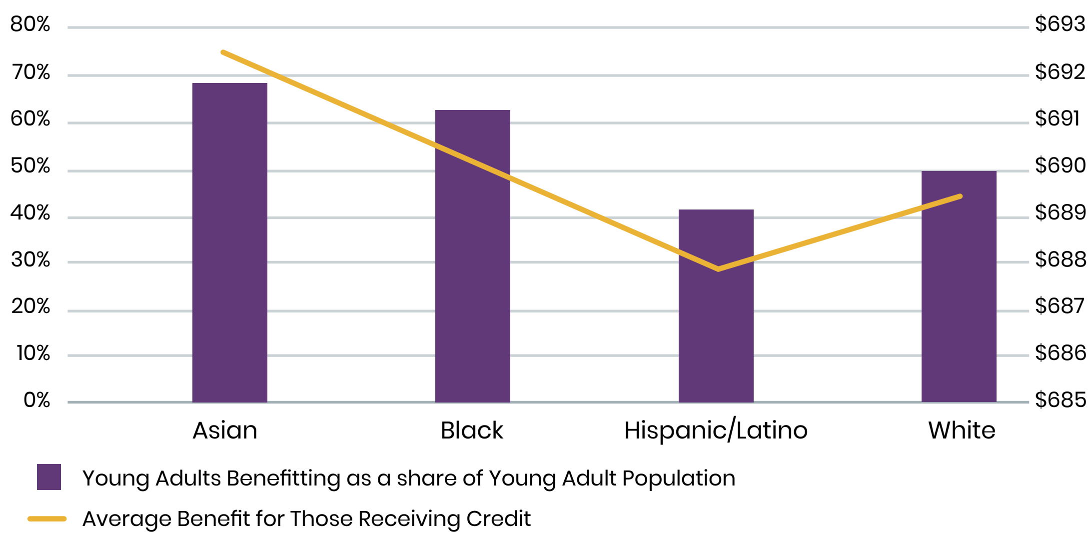
Source: Indiana Department of Education

- **Extend State EITC eligibility to non-custodial parents:** Extending Sate EITC eligibility to noncustodial parents can benefit those who work and pay their child support in full. A noncustodial parents EITC would operate like the child-based EITC, providing a refundable tax credit to low-income working parents and encouraging work. Under current federal income tax rules, low-income noncustodial parents are ineligible for the EITC benefits available to low-income families with children, even when they support their children through full payment of child support. A noncustodial parents EITC policy can reduce this disparity and increase incentives for work and payment of child support. The State can limit a noncustodial parent's EITC to those in the child support enforcement program, as is done in New York and Washington, D.C., to simplify the administration of this new EITC.[35]

Nationally

- **Expand EITC benefits to childless older youth:** Workers ages 18 to 24 without qualifying children are ineligible for the EITC. As a result, the federal EITC lifts few low-income young adult workers without qualifying children out of poverty. As well, the social benefits realized by EITC recipients with qualifying children, such as improved long-term health, career, and education outcomes, do not extend to recipients without qualifying children because they receive smaller tax credits.[36] The American Rescue Plan (ARP) temporarily expanded the value of the credit for low-income people without dependents and allowed workers ages 19 to 24 to claim the EITC for the first time. Under the ARP expansion of EITC, 165,000 workers ages 19 to 24, which is about 47% of Indiana's older youth population, received the EITC benefit. The average credit was $690, for a total of $93.3 million paid to Indiana residents. Asian and Black older youth (as a share of the youth adult population) comprised the highest percentage of those who received EITC benefits. The expansion of EITC to older youth expired at the end of 2021.[37] Expanding EITC benefits permanently – a program recognized for bringing low-income individuals into the labor force – can reduce the poverty rates and raise the employment rates of young adults in Indiana.[38]

Percentage of and Amount Received by Older Youth Ages 19 to 24 under EITC Expansion by Race/Ethnicity, Indiana: 2021



Source: Indiana Department of Education

- **Extend CTC benefits under ARP permanently:** The expansion of CTC under ARP expired at the end of 2021. This expansion potentially reduced child poverty by 34% and deep child poverty by 39%. A permanent expansion of the CTC could have a large anti-poverty effect on children.[39] Extending the ARP CTC benefits permanently under legislation could maintain these anti-poverty gains and prevent any backsliding. On the contrary, a reduction of these benefits could lead to 175,000 children under 18 to slip back below the poverty line.[40] Extending the expansions of CTC and EITC under the ARP to at least 2025 could provide families economic stability, especially as they continue to recover from the pandemic.

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