

Direct Stimulus Proposal – Proposal to Extend Certain Tax Benefits and Payments to Puerto Rico Residents

Overview –

The proposal would extend certain tax benefits to residents of Puerto Rico. Such benefits include the earned income credit (EIC), child tax credit, and Supplemental Security Income (SSI) payments. Extending these tax benefits and payments would affect the majority of Puerto Rican residents, providing greatest benefits to the lower income and working poor residents.

Earned Income Credit –

Present Law – Under current law EIC, certain working poor families paying payroll taxes, but not Federal Income taxes, may claim a refundable tax credit to offset their payroll taxes. However, Puerto Rican residents that maintain a household in Puerto Rico may not claim the earned income credit on a US return.

Proposed Changes – The proposal would modify Internal Revenue Code (IRC) section 32(c)(1)(E) to extend a refundable earned income credit to Puerto Rico residents. The proposal would allow certain low-income households in Puerto Rico to claim the EIC in a manner consistent with the tax benefits available to certain low-income families filing US income tax returns.

In general, the proposal would provide a refundable earned income credit to low-income households with earned income below the income thresholds. The credit amount would vary with the presence of qualifying children, marital status, as well as with earned income.

Qualifying children are those individuals that satisfy relationship, residency, and age tests and for whom the taxpayer satisfies an identification requirement. In general, the child must be the taxpayer's descendant, adopted child, stepchild, or eligible foster child to qualify.

Table 1 summarizes the refundable earned income credit by the number of qualifying children as well as the maximum credit amount.

Table 1 – Present Law – Earned Income Credit
Refundable Credit for 2003 Income¹
 (For certain low-income individuals with earned income²)

<u>Children</u>	<u>Earned Income Income up to</u>	<u>Maximum Credit</u>	<u>Earned Income Phase-out Range</u>
0	\$ 5,000 – \$ 5,450	\$ 382	\$ 6,240 – \$11,060
1	\$ 7,400 – \$13,550	\$2,547	\$13,730 – \$29,200
2 or more	\$10,400 – \$14,550	\$4,204	\$14,520 – \$34,178

Estimated Benefits – Fully Phased-in EIC

- An estimated 59 percent of Puerto Rican residents would receive some portion of the EIC.
- Approximately 58 percent of married couples with children would receive some portion of the EIC.
- Approximately 69 percent of heads of households with children (single parents) would receive some portion of the EIC.

Child Tax Credit –

Present Law – Puerto Rican residents that file a US income tax return and who have three or more children can currently claim the nonrefundable child tax credit. The credit is allowed only to the extent that it offsets their employee share of payroll tax liability.

Proposed Changes – The proposal would modify IRC section 24 to extend the child tax credit to Puerto Rican residents currently (1) not filing US Federal income tax returns and (2) filing US returns with less than three children. Extending the credit to all Puerto Rico residents would make the available credit consistent with those credits available to US taxpayers.

¹ Earned income phase out for two or more children is for married taxpayers filing jointly. The earned income phase out for two or more children for unmarried taxpayers is the same as for one child, \$13,730.

² Earned income includes all wages, salaries, tips, and other employee compensation, plus the amount of the taxpayer's self-employment income. Earned income also includes such nontaxable compensation as quarters and subsistence allowances for the military. Earned income does not include interest and dividends, welfare benefits, veteran's benefits, pension or annuities, alimony, social security benefits, or workers and unemployment compensation.

The proposal would allow a credit amount of \$1,000 per qualifying child (consistent with HR 2, The Jobs and Growth Tax Relief Reconciliation Act of 2003).

US taxpayers, under present law, may claim the child tax credit of \$1,000 for eligible children. Eligible children are descendants, stepchildren, or eligible foster children who are US citizens or resident aliens. Eligible children are those for whom the taxpayer may claim a dependency exemption and who are less than 17 years old as of the close of the tax year.

Present law phases out the child tax credit based on the adjusted gross income of taxpayers (AGI). The child tax credit begins to phase out when modified AGI reaches \$110,000 for married taxpayers filing jointly and \$75,000 for single taxpayers.³ The credit amount is reduced by \$50 for each \$1,000 of AGI above the income threshold.

Under IRC section 26(b) a portion of the child tax credit is refundable for all taxpayers based on AGI, regardless of the amount of the taxpayer's regular tax liability. For tax years through 2004, the child tax credit is refundable to the extent of 10 percent of the taxpayer's earned income in excess of \$10,000.⁴

Families with three or more children may elect to apply an alternative method to calculate their refundable portion of the child tax credit. Under IRC section 26(a) the limit on the nonrefundable portion of the child tax credit is equal to the excess of total tax liability over the sum of the taxpayer's other nonrefundable tax credits. The following example demonstrates the limitation on the per child credit.

Taxpayer Total Liability	\$1,500
Minus Nonrefundable Credits (<i>Not including the child tax credit</i>)	<u>- 300</u>
Excess tax liability	1,200
Child Tax Credit (four children)	2,400
Limit on refundable portion	<u>\$1,200</u>

Estimated Benefits – Preliminary estimates indicate that approximately 57% of Puerto Rican households would benefit from the child tax credit.

³ The child tax credit begins to phase out when modified AGI reaches \$55,000 for married taxpayers filing separately.

⁴ The refundable portion of the child tax credit is limited by the overall per child credit amount. The percentage increases from 10 to 15 percent in 2005.

Supplemental Security Income –

Present Law – The Supplemental Security Income (SSI) program, which provides cash payments to needy adults who are aged, blind, or disabled does not operate in Puerto Rico. Its predecessor programs that provided matching grants to state governments were not replaced by SSI in Puerto Rico and continue today.⁵

Proposed Changes – Under SSI, individuals receive benefits set by the federal government. Individuals are eligible for benefits if income is less than \$545 per month (\$817 for a couple, both of whom are aged, blind or disabled) and countable resources are less than \$2,000 (\$3,000 for a couple); \$545 per month per individual and \$817 per couple are the maximum monthly benefits.

Estimated Benefits – Extending SSI benefits to Puerto Rican residents would increase payments to 44% of eligible (elderly and disabled) residents.

⁵ Social Security Act Title I, Grants to States for Old-Aged Assistance for the Aged; Title X, Grants to the States for Aid to the Blind; Title XIV, Aid to the Permanently and Totally Disabled; and Title XVI, Grants to the States for the Aid to the Aged, Blind, and Disabled.