## The Daily Dish

# Refundable Tax Credits

**DOUGLAS HOLTZ-EAKIN | JANUARY 23, 2025**

As Congress prepares to address the expiring provisions of the 2017 Tax Cuts and Jobs Act (TCJA), one important consideration is the future of the clean energy tax credits in the Inflation Reduction Act (IRA). Should they be repealed as part of the tax legislation? Does this constitute a tax hike (other things equal)?

An important feature of these credits is that most are *refundable* tax credits. In English, this means that if one's tax liability is smaller than the tax credit, your taxes are first pushed to zero and then the remainder is sent to the taxpayer as a check. This is typically most important for low-income taxpayers.

In the example below, Ms. Meager is a low-income taxpayer with a tax rate of 10 percent. Mr. Mogul has a tax rate of 33 percent and an income 10-times larger than Ms. Meager's. If both are eligible for a $5,000 refundable tax credit, Ms. Meager's pre-credit tax liability of $1,500 will be eliminated and the remaining $3,500 is sent to her as a check. In contrast, Mr. Mogul's tax liability is simply reduced by the full $5,000. Getting rid of the tax credit would be a $1,500 tax hike on Ms. Meager and a $5,000 tax increase on Mr. Mogul.

But this is entirely driven by the current budget treatment of refundable tax credits, which treats only the refunded part ($3,500 in our example) as an outlay. It makes sense – at least to Eakinomics – that by creating a refundable credit, Congress has committed to $5,000 per taxpayer, since it does not know what their future income (or taxes) will be. This is shown in the second panel of the table, where all $5,000 is treated as an outlay.

In this case, the repeal is not a tax increase for anyone. Instead, it is simply a reduction in spending, which is the economic reality.

Taxable Pre-Credit Tax

| | Income | Tax | Credit | Net Tax | Spending |
|---|---|---|---|---|---|
| Ms. Meager | $15,000 | $1,500 | $5,000 | $0 | $3,500 |
| Mr. Mogul | $150,000 | $50,000 | $5,000 | $45,000 | $0 |
| | | | | | |
| Ms. Meager | $15,000 | $1,500 | $5,000 | $1,500 | $5,000 |
| Mr. Mogul | $150,000 | $50,000 | $5,000 | $50,000 | $5,000 |

This little example carries two larger morals. The first is that if distribution tables were prepared using an economically realistic budget treatment of the refundable credits, then it would be possible for Ms. Meager to get a tax cut. At present, there is no way to do so. The only option is a bigger refundable credit.

But that is just more spending, which leads to the second moral. When looking for spending reductions to deal with the fiscal outlook, it is important to remember that there is a lot of spending in the tax code that should be fair game.