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American Rescue Plan Act Provides Critical, Permanent Tax Relief to Puerto Rico

By Javier Balmaceda

The newly enacted American Rescue Plan Act extended to Puerto Rico substantial amounts¹ of funding, to aid both the territory's short-term recovery from the COVID-19 pandemic and its long-term recovery from a decade-long recession and recent natural disasters. For instance, the Rescue Plan features more than \$4 billion in fiscal relief funding for Puerto Rico and its municipalities to mitigate the fiscal effects stemming from COVID-19, and \$3 billion in education assistance to ensure the safety of schools and students during the pandemic.

On the long-term track, the Rescue Plan included two crucial, permanent provisions: one extends the Child Tax Credit to families of all sizes in Puerto Rico, and the other provides funding to substantially expand Puerto Rico's local Earned Income Tax Credit (EITC). These measures combined are estimated to provide north of \$1 billion annually in critical benefits to hundreds of thousands of low- and moderate-income working people and families in Puerto Rico, thereby helping to tackle the territory's acute poverty and low labor force participation.

Rescue Plan Boosts Child Tax Credit for Puerto Rico Families

Since the inception of the Child Tax Credit in 1997, only families with three or more children in Puerto Rico — just 11 percent of all families with children in the territory² — have been eligible to receive any Child Tax Credit. After many years of proposals being advanced, the Rescue Plan fixes this flaw in the law and extends, on a permanent basis, the Child Tax Credit to families with one or two children.

Families in Puerto Rico will now receive the same Child Tax Credit as families in U.S. states.³ Importantly, the Rescue Plan also substantially increased the underlying Child Tax Credit

¹ The White House, "The American Rescue Plan Act Provides Relief to Puerto Rico," March 2021, <https://www.whitehouse.gov/wp-content/uploads/2021/03/ARP-Puerto-Rico-Fact-Sheet.pdf>.

² María E. Enchaetegui *et al.*, "The Effects of Covid-19 on the Economic Security of Families and Children in Puerto Rico: Vulnerabilities, Projections, and Recommendations," Youth Development Institute of Puerto Rico, May 27, 2020, https://parsefiles.back4app.com/NnOrAmAotAZqACgSOms8WkAwkOIqpZ6VWjoFVKkJ/34fa140a3fdebb09e296d7328112a9b8_COVID-19%20REPORT%20ENG.pdf.

³ The one exception is that the American Rescue Plan Act requires the Internal Revenue Service to provide families with advance payments of their 2021 Child Tax Credit between July and December 2021, but this requirement does not apply in Puerto Rico.

temporarily in 2021. The full tax credit will be available to families with low or no earnings. The maximum amount of the tax credit will rise from \$2,000 per child to \$3,600 for children under age 6 and to \$3,000 for older children, including, for the first time, 17-year-olds.⁴

For example, a single mother with a toddler and a second grader who earns \$10,000 a year providing in-home care to older people (with work hours that fluctuate significantly from month to month) was previously ineligible to claim the Child Tax Credit in Puerto Rico because her family did not include three or more children. Under the Rescue Plan, that mother can now claim a Child Tax Credit of \$6,600 in 2021 due to the one-year nationwide expansion.

Extending the benefits of the Child Tax Credit to all eligible families in Puerto Rico will provide much-needed support to tackle the territory's high poverty rate, which stands as high as 44 percent for the overall population and 58 percent for children. Nationwide, we estimate the Rescue Plan's changes to the Child Tax Credit will lift 4.1 million children above the poverty line — cutting the number of children in poverty by 40 percent.⁵

The next crucial step is to make the temporarily expanded Child Tax Credit permanent to secure a landmark achievement in reducing child poverty. Without action, after 2021, the Child Tax Credit for all eligible families in the U.S. states and in Puerto Rico will once again apply just to children under age 17 and will revert to a maximum credit of \$2,000 per child or \$1,400 per child for families with no federal income tax liability — which will be common in Puerto Rico, where working families pay payroll taxes but typically not federal income taxes. And the credit will be restricted further for lower-income families, as it will only phase in at 15 cents on the dollar for earnings above \$2,500. The mother in the example above would receive \$5,475 less, or \$1,125, after 2021 if the one-year expansion in the Rescue Plan expires. This underscores the need for a major policymaker drive to make this critical Child Tax Credit expansion permanent.

Earned Income Tax Credit Supplement Will Make Credit More Effective

The American Rescue Plan Act also provides an annual, federal supplement to Puerto Rico to expand the territory's local EITC, enacted in 2019. This permanent supplement starts at \$600 million in 2022 and grows with inflation thereafter. (Workers in Puerto Rico are not eligible for the federal EITC, so they will not benefit from the Rescue Plan's changes to the federal EITC.⁶)

The Rescue Plan's federal supplement represents the first-ever federal EITC dollars for the territory since the federal credit was established nearly half a century ago. Puerto Rico had its own EITC from 2007 to 2013, but policymakers ended it in 2014 amid the government's deepening fiscal

⁴ The \$1,000 and \$1,600 increase in the maximum amount for 2021 begins to phase out at \$75,000 for single filers, \$112,500 for heads of household, and \$150,000 for married joint filers.

⁵ Chuck Marr *et al.*, "American Rescue Plan Act Includes Critical Expansions of Child Tax Credit and EITC," CBPP, March 12, 2021, <https://www.cbpp.org/research/federal-tax/american-rescue-plan-act-includes-critical-expansions-of-child-tax-credit-and>.

⁶ In the U.S. states, the American Rescue Plan Act raises the maximum EITC for workers without children from roughly \$540 to roughly \$1,500, and the income cap for these adults to qualify from about \$16,000 to at least \$21,000. It also expands the age range of eligible workers without children to include younger adults aged 19-24 (excluding students under 24 who are attending school at least part time), as well as people aged 65 and over.

crisis. The new EITC that took effect in 2019, while better designed than Puerto Rico's original one, was estimated at the time of enactment to provide only about \$200 million of assistance to low-wage working families⁷ — a sum that is far too small for the credit to achieve its intended goals of reducing poverty and increasing the territory's low labor force participation rate, which was 39.9 percent in January 2021.⁸

The Rescue Plan's federal supplement will cover the first \$600 million cost of the EITC expansion above the \$200 million base amount, effectively quadrupling the program's size (up to \$800 million). This expansion should make the territory's EITC far more effective at achieving its desired goals for working families.

The precise structure of Puerto Rico's expanded EITC is still undefined, as the territory's legislature will have to pass a law to delineate how the credit will be expanded to take advantage of the federal supplement. The legislature should seek to approve new parameters that maximize achieving the main goals of the EITC, which are to reduce poverty and incentivize labor force participation. For instance, increasing the phase-in rate, which is the rate at which the EITC rises as a low-income household earns more, and increasing the maximum credit amounts for those households would be effective ways of achieving those goals.

In addition, the Rescue Plan included \$1 million annually through 2025 for education and outreach, to boost the number of eligible tax filers in Puerto Rico who claim the EITC. Such efforts will be particularly important, as only 258,000 workers received the EITC in its first year, at a cost of \$115 million — well below the estimated level.⁹

The enactment of the federal supplement for Puerto Rico's EITC — alongside the full benefits of the Child Tax Credit — will serve as powerful tools to tackle the territory's deep poverty and chronically low labor force participation. And, more broadly, these two credits will come as great relief for a U.S. jurisdiction that has endured great hardship in its recent past, including 15 years of economic decline, numerous natural disasters, an ongoing bankruptcy process, and the largest outmigration pattern in the whole of the United States in the last decade.¹⁰

⁷ Javier Balmaceda, "Puerto Rico on the Verge of Implementing an EITC," CBPP, December 10, 2018, <https://www.cbpp.org/blog/puerto-rico-on-verge-of-implementing-an-eitc>.

⁸ See Puerto Rico Department of Labor, Monthly Report on Employment and Unemployment, January 2021, <http://www.mercadolaboral.pr.gov/lmi/pdf/Grupo%20Trabajador/2021/EMPLEO%20Y%20DESEMPLEO%20EN%20PUERTO%20RICO%201.pdf>.

⁹ See letter from the Financial Oversight and Management Board for Puerto Rico, March 26, 2021, <https://drive.google.com/file/d/1lcWUq7x4UQo6ElfqgHBBSb4LP1e5orPh/view>.

¹⁰ Javier Balmaceda, "Long in a Recession, Puerto Rico Needs More Than Just COVID-19 Relief to Overcome Its Crises," CBPP, May 7, 2020, <https://www.cbpp.org/research/economy/long-in-recession-puerto-rico-needs-more-than-just-covid-19-relief-to-overcome-its>.