Taxes Explained: Tax Credits and Deductions

Tax Code Should Help Families Achieve Economic Security and Mobility

BY: ELIANA GOLDING

Key Takeaways

A fierce tax debate is already underway in Congress, and the stakes are high for hardworking families. Lawmakers are debating and negotiating major changes to the tax code, including certain **tax deductions and tax credits,** which are two methods of lowering a taxpayer's tax liability while encouraging or subsidizing certain activities, like purchasing health insurance or caring for children. Instead of bolstering relief to help families access critical public goods and services, Republicans in Congress are pushing policy changes to help the rich keep or grow their wealth.

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People across the country face economic hardship from inflation, corporate greed, and policies that have eroded financial assistance programs. The tax plan that the Trump administration and congressional Republicans are pursuing will make things worse. Their plans include extending a special tax deduction for business owners that mostly benefited households earning more than $1 million.[1] They also intend to weaken a tax credit for families who purchase health coverage through the Health Insurance Marketplace, which would leave 4 million people, almost half of whom are Black or Latino, unable to afford their health insurance.[2]

The tax code should be a tool to more equitably distribute resources. It should raise sufficient revenue to support the public good and provide relief for everyday people – particularly Black and brown people who face overlapping inequalities that make it hard for them to meet their needs, achieve economic security, and plan for the future.

Background

During his first administration, President Trump and Republican members of Congress cut taxes for wealthy households and corporations in a major tax reform bill called the "Tax Cuts and Jobs Act" (TCJA). The bill was massively expensive, delivered major tax benefits to the already wealthy, and did little for households with low or moderate incomes. With some elements of that bill set to expire at the end of 2025, President Trump and Republican lawmakers are seizing the opportunity to further reshape the tax code to align with the interests of the wealthy.

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In a fair tax code, tax credits and deductions can advance equity by alleviating cost burdens for taxpayers who may struggle to maintain economic security or by helping people access economic opportunities. For example, tax credits like the Earned Income Tax Credit (EITC) and the Child Tax Credit (CTC) provide direct financial relief to households with low or moderate incomes, helping cover essential expenses, including child care, health care, housing, and other necessities. While it is still unclear exactly what tax policy changes Congress will pursue, there are a few credits and deductions that will be prominent in this year's debate.

What are tax deductions?

Tax rules allow an individual to deduct a certain amount of income that is not subject to being taxed based on many factors like income levels, family size, number of children, assets, charitable giving, state and local taxes paid, and other qualifying expenses. These tax deductions reduce a person's taxable income before the tax rate is applied. Tax deductions lower a person's tax liability because less of their income is subject to tax. When filing federal taxes, a person can choose between two deduction options:

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- **Standard deduction:** If a taxpayer takes the standard deduction, they reduce their taxable income by a flat amount. In 2025, an individual can deduct $15,000 from their income, and a married couple filing their taxes together can deduct $30,000 from their household income.[3]

- **Itemized deductions:** Itemizing deductions allows taxpayers to list out and deduct certain qualifying expenses from their taxable income. These qualifying expenses include the amount the taxpayer paid in state and local taxes (up to $10,000), charitable contributions, mortgage interest, and others.

Taxpayers itemize only when their qualifying expenses exceed the standard deduction, which occurs more frequently among higher-income households. Black and Hispanic families benefit less from itemized deductions than white families because, on average, those families have lower incomes and are therefore less likely to itemize their deductions.[4] In 2022, 38 percent of households earning more than $200,000 itemized their deductions, while only 7 percent of those making under $200,000 itemized.[5]

What are tax credits?

A tax credit directly reduces a person's actual tax liability, or tax bill. Unlike deductions (which reduce income before calculating tax), credits directly subtract from the amount of tax you owe after all calculations are complete. There are two types of tax credits:

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- **Nonrefundable credits**: A taxpayer can use a nonrefundable credit to reduce their tax bill down to zero. However, if the tax credit is larger than the amount of taxes owed, the taxpayer will not receive the full credit amount. For example, if a family qualifies for a *nonrefundable* $2,000 tax credit but their tax liability is only $1,800, they will not receive the remaining $200 of value.

- **Refundable credits:** When a credit is refundable, it can reduce a taxpayer's tax liability below zero, which will result in a tax refund. For example, if a family qualifies for a *refundable* $2,000 tax credit but their tax liability is $1,800, they will receive $200 as a tax refund.

Credits and Deductions Policy Spotlight

Credits	
Policy	**Why is it relevant this year?**
Child Tax Credit The Child Tax Credit (CTC) is a partially refundable credit that allows families with U.S. citizen (or qualifying noncitizen) children under the age of 17 to claim a credit of up to $2,000 per child.[6] Families with low incomes who pay less than $2,000 per child in federal income taxes can receive up to $1,700 as a tax refund, if the amount of the credit is greater than the family's federal tax liability. The CTC starts to phase out for families with incomes over $200,000 for a single parent or $400,000 for a married couple.[7] The TCJA temporarily raised the maximum value of the child tax credit to $2,000 from $1,000 per child and required that children have a Social Security number to be eligible.	There is an opportunity this year to increase the credit amount, expand eligibility for the CTC to children without Social Security numbers, and make it fully refundable so families with very low incomes can access the full credit. Together, these changes could potentially reduce child poverty by 40 percent.[8] Without any action from Congress, this expansion will expire at the end of 2025, meaning the CTC amount per child would revert to $1,000 in 2026.
Affordable Care Act Premium Tax Credit Enhancement The Affordable Care Act (ACA) Premium Tax Credit (PTC) is a refundable credit that reduces health insurance costs for qualifying households who buy their coverage through the Health Insurance Marketplace. Congress passed an enhancement for the PTC through the American Rescue Plan Act (ARPA) and then extended the enhancement as part of the Inflation Reduction Act (IRA) of 2022. Because the enhancement helps make health insurance much more affordable for eligible people, enrollment in ACA marketplace plans grew rapidly, increasing by 5 million people in 2024.[9]	If Congress allows the PTC enhancement to expire, almost everyone who purchases health insurance on the ACA marketplace will see their costs increase significantly. Enrollment in the subsidized marketplace would decrease by 7.2 million, and an estimated 4 million people would lose health insurance.[10]

Deductions	
Policy	**Why is it relevant this year?**
State and Local Tax Deduction The State and Local Tax (SALT) deduction allows taxpayers who itemize their deductions on their federal tax returns to deduct the amount they paid in certain state and local taxes, including state and local income, property, and sales taxes.[11] The TCJA placed a $10,000 cap on the SALT deduction.	Eliminating or significantly raising the SALT cap, as congressional Republicans and President Trump have proposed, will almost exclusively benefit households with high incomes. It would also cost the country between $10 billion and $100 billion per year, depending on the policy design.[12]
The Pass-through Deduction The TCJA created the pass-through deduction, which allows the owners of certain types of businesses, including sole proprietors and partnership or S corporation owners, who report their business income on their federal individual income taxes to deduct 20 percent of their business income when calculating their taxes.[13]	Extending the pass-through deduction will be a windfall for wealthy, mostly white business owners, which will widen inequality and cost the country over $770 billion in revenue over 10 years.[14] The pass-through deduction will end in 2025 unless Congress decides to extend it.

Impact on Equity

Congressional Republicans' tax plans will widen the racial wealth divide and lead to negative health outcomes for Black and brown children and families. Here's how:

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Limiting or eliminating access to vital financial assistance

Tax credits like the Child Tax Credit (CTC) and the enhanced ACA Premium Tax Credit (PTC) provide financial assistance to families who need it. However, if Congress fails to expand eligibility for the CTC and lets the enhanced PTC expire, they will deprive millions of children and families with low and moderate incomes of this critical support.

Strict Eligibility Requirements

While the TCJA did double the maximum child tax credit amount, it limited eligibility by requiring that qualifying children have Social Security numbers, thereby excluding children who previously qualified using Individual Taxpayer Identification Numbers (ITINs), disproportionately impacting immigrant households and excluding around 1 million immigrant children from the CTC.[15] If Congress makes no changes to the CTC, this provision will expire this year. However, some congressional Republicans are aiming to *further* restrict eligibility for the CTC by requiring that both children and parents have Social Security numbers to qualify for the CTC. This means that parents with ITINs, a disproportionate number of whom are Black and brown households, will lose the ability to claim the CTC for their children.[16]

Limited Access to Full Credit

The TCJA also failed to make the CTC fully refundable, which excluded the millions of children whose families do not earn enough to qualify for the full credit. Because the CTC caps the per-child refund amount at $1,700, families with low incomes who pay less than $2,000 in federal income taxes will not receive the full amount of the credit. Because of racial disparities in income, this disproportionately harms Black and brown children. As a result of the partially refundability of the CTC:

- Three-quarters of white children are eligible for the full CTC, compared with only half of Black and Hispanic children.[17]
- About 2 million children will receive no benefit from the CTC, because their families earn less than $2,500.[18]
- Around 17 million children under 17 years old will not receive the full value of the credit in 2025, because their family's income is too low.[19]

Undoing Progress from Temporary Expansion Success

Congress temporarily expanded eligibility for the CTC in 2021 in response to the COVID-19 pandemic, giving families with low incomes access to the full credit amount. Expanding access to the full CTC amount cut child poverty in half in 2021. Studies showed boosting families' incomes led to improved educational and health outcomes for children.[20]

The **enhancements to the ACA premium tax credits**, initially enacted by the American Rescue Plan Act (ARPA) and later extended through the Inflation Reduction Act (IRA), have been instrumental in helping 20 million Americans access affordable health coverage, with particularly significant impacts for Black and brown families.[21] Between 2021 and 2024, marketplace enrollment surged among Black and Latino people by 186 percent and 158 percent respectively – compared with only 63 percent growth seen among other racial and ethnic groups.

However, these enhanced premium tax credits are scheduled to expire after 2025, threatening to reverse these gains for equitable access to affordable health care. If Congress allows these tax credit enhancements to expire, families will face substantial premium increases, potentially pricing many out of the insurance market entirely.[22] The consequences would be severe: An estimated 4 million people, almost half of whom are Black or Latino, would lose the ability to afford their health insurance coverage.[23]

Cutting taxes for the already wealthy

Congressional Republicans and President Trump have expressed support for eliminating or significantly raising the cap on the **SALT deduction**. Doing so would almost exclusively benefit white households with very high incomes, widening the racial wealth divide and costing the country billions of dollars. A study from the Institute on Taxation and Economic Policy (ITEP) showed that white families earning more than $200,000 would receive more than two-thirds of the tax cuts if the SALT cap is repealed. And if Congress doubles the cap to $20,000, it would cost the country $225 billion over 10 years[24]

The SALT deduction primarily benefits households with higher incomes.[25] To claim the SALT deduction, a household must itemize their deductions, rather than take the standard deduction. Taxpayers with higher incomes are more likely to itemize their deductions because the value of their deductions is often higher than the standard deduction, which is currently $15,000 for an individual and $30,000 for a married couple.[26] Capping the SALT deduction limits how much taxpayers can deduct from their taxable income. An analysis from the Bipartisan Policy Center shows that the $10,000 cap primarily impacted households making over $200,000.[27]

The pass-through deduction is a special loophole for owners of businesses and has overwhelmingly benefited the richest households. It is set to expire at the end of 2025, but conservative lawmakers are now pushing to make it permanent. In 2023, 90 percent of the benefit from the pass-through deduction went to white households, while Black households received 5 percent of the benefit and Hispanic households received only 2 percent. In 2019, 64 percent of the benefits from this tax cut went to households earning over $410,000. [28] Extending the pass-through deduction will widen inequality by cutting taxes for wealthy, mostly white, business owners, while costing the country $770 billion in revenue over 10 years.[29]

Policy Recommendations

This is a pivotal moment for tax policy, and we have a duty to fight for a more equitable tax code that uses credits and deductions to help families achieve economic security and mobility. Instead of leveraging credits and deductions to line the pockets of their wealthy allies, Congress should advance tax policies that help families, particularly Black and brown people who have been historically excluded from economic opportunity, access health insurance, care for their children, and invest in their futures. Congress can start by:

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- **Improving access to credits that provide financial lifelines to families:**
    - Strengthening and expanding tax credits like the Child Tax Credit to better support working families. This includes making the credit fully refundable, increasing the overall credit amount, and ensuring eligibility for those who do not have Social Security numbers so must file their taxes with Individual Tax Identification Numbers (ITIN).
    - Extending and enhancing the Affordable Care Act Premium Tax Credits to keep health coverage affordable by lowering premiums and out-of-pocket costs.

- **Rejecting proposals to extend or expand deductions for the wealthy by:**
    - Opposing efforts to expand or extend deductions that primarily benefit corporations and white, wealthy Americans, further entrenching economic inequality.
    - Prioritizing tax policies that close loopholes and ensure corporations and the ultra-wealthy pay their fair share, rather than allowing them to shield income through unnecessary deductions.

Endnotes

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Our Work to Build Power

For decades, Dēmos has been committed to advancing racial justice by working at the intersection of economic justice and democracy reform. Our recent publication, the Dēmos Power Agenda: A Framework for Building People Power, outlines our vision for creating a just, inclusive, multiracial democracy and economy. The Power Scorecard offers a data framework and tool to establish a baseline of the current economic, civic, and political conditions we face as we fight for that multiracial democracy and economy.

About Dēmos

Dēmos is a non-profit public policy organization working to build a just, inclusive, multiracial democracy and economy. We work hand in hand to build power with and for Black and brown communities, forging strategic alliances with grassroots and state-based organizations.

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