NATIONAL WOMEN'S LAW CENTER
EXPANDING THE POSSIBILITIES

M E M O R A N D U M

To: Individuals and Organizations Interested in Child Care
From: Nancy Duff Campbell, Amy K. Matsui and Arlene Brens
Date: April 7, 2009
Re: Developments in Federal and State Child and Dependent Care Tax Provisions in 2008

Tax provisions for child and dependent care expenses can provide valuable assistance to families struggling to pay for the care necessary for them to earn a living. Currently, 28 states (including the District of Columbia) have child and dependent care (CADC) tax provisions, and the value of these provisions has increased in most of these states in recent years. But there is still much that can be done to expand the number of provisions, improve existing provisions, and inform families about these and other state and federal tax provisions that can help them meet their child care and other expenses.

This memorandum summarizes changes to state and federal child and dependent care tax provisions that took effect or were enacted or promulgated in 2008. Since the National Women's Law Center's February 2008 update[1] to the April 2006 edition of its quadrennial report, *Making Care Less Taxing: Improving State Child and Dependent Care Tax Provisions*[2] and accompanying state-by-state report card, *Making the Grade for Care,*[3] which evaluated provisions in effect as of the end of 2005, previously legislated changes in Georgia, Louisiana, and Oklahoma took effect in tax year 2008. No states enacted changes to their CADC provisions or enacted new provisions in 2008.

At the federal level, the Fostering Connections to Success and Increasing Adoptions Act of 2008[4] changed the definition of "qualifying child" for the purposes of federal child-related tax provisions, including the federal CADC credit, beginning in tax year 2009. In addition, new Internal Revenue Service regulations gave further content to the statutory definition of "custodial parent" and the extent to which divorced or separated parents can claim child-related tax benefits, including the federal CADC credit, beginning in tax year 2009.[5]

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[1] National Women's Law Center's February 2008 Update Re: Developments in Federal and State Child Care Tax Provisions in 2007 (Feb. 26, 2008) [hereinafter February 2008 update to *Making Care Less Taxing*], *available at* http://www.nwlc.org/pdf/2008MCLTMemo.pdf (last visited April 3, 2009).
[2] MAKING CARE LESS TAXING: IMPROVING STATE CHILD AND DEPENDENT CARE TAX PROVISIONS (April 2006)[hereinafter *Making Care Less Taxing*], *available at* http://www.nwlc.org/pdf/MakingCareLessTaxing2006.pdf (last visited April 3, 2009).
[3] MAKING THE GRADE FOR CARE: RANKING STATE CHILD AND DEPENDENT CARE TAX PROVISIONS (April 2006), *available at* http://www.nwlc.org/pdf/MakingTheGradeForCare2006.pdf (last visited April 3, 2009).
[4] Pub. L. No. 110-351, 122 Stat. 3949 (2008), *available at* http://frwebgate.access.gpo.gov/cgi-bin/getdoc.cgi?dbname=110_cong_bills&docid=f:h6893enr.txt.pdf (last visited April 6, 2009).
[5] Dependent Child of Divorced or Separated Parents or Parents Who Live Apart, 73 Fed. Reg. 37,797-02, 37,801 (July 2, 2008) (to be codified at 26 C.F.R. § 1.152-4).

Although the American Recovery and Reinvestment Act[6] signed on February 17, 2009, contained improvements to federal tax provisions for low- and moderate-income families effective for tax years 2009 and 2010 (including in the Earned Income Tax Credit (EITC),[7] Child Tax Credit (CTC),[8] and a new Making Work Pay Tax Credit[9]) it did not change the federal CADC credit. In a later memorandum the Center will provide information on these new tax provisions.

Finally, this memorandum reminds advocates of the materials available as part of the Center's Tax Credits Outreach Campaign to help increase the number of families eligible for and claiming these and other child-related federal and state tax provisions. As we enter the final days of this year's tax filing season, and especially given the current economic situation, it is important to keep up the effort to help families claim these provisions.

Changes in State Law Provisions Effective in 2008

In Georgia, a previously legislated change to the CADC credit described in the Center's January 2007[10] and February 2008 updates to *Making Care Less Taxing* took effect in 2008. The value of the state credit increased from 20% to 30% of the federal CADC credit, increasing the maximum value from $420 for tax year 2007 to $630 for tax year 2008.[11] The credit is not refundable.

When a state credit, as in Georgia, is calculated as a percentage of the federal CADC credit, an issue arises regarding calculation of the state credit for families who receive only part or none of the federal credit because the federal credit exceeds their tax liability but is not refundable. Is the state credit based on the amount of the federal credit the family actually received, or is it based on the amount the family could have received before the federal credit's nonrefundability provision limited the federal credit actually received?

The Georgia statute directs tax filers to calculate the Georgia CADC credit based on the federal credit that is "claimed and allowed," and Georgia's 2008 tax forms and instructions direct tax filers to calculate their state credit based on the amount of the federal credit a family receives, rather than the amount the family could have received if its federal credit had not been limited by its federal tax liability. For example, if a family's federal credit is $800 but its federal tax liability is only $100, the family receives a federal credit of only $100. The family's Georgia credit would be worth just $30 (30% of $100), rather than the $240 (30% of $800) it would be worth if the state credit were based on the full value of the federal credit before it is limited by federal tax liability.

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[6] Pub. L. No. 111-5, 123 Stat. 115 (2009), *available at* http://www.opencongress.org/bill/111-h1/text (last visited April 6, 2009).
[7] Pub L. No. 111-5. § 1002, 123 Stat. at 312.
[8] Pub. L. No. 111-5. § 1003, 123 Stat. at 313.
[9] Pub. L. No. 111-5, § 1001, 123 Stat. at 309-10.
[10] National Women's Law Center's January 2007 Update Re: Developments in Federal and State Child Care Tax Provisions in 2006 (Jan. 31, 2007), *available at* http://www.nwlc.org/pdf/MCLT%202007%20Memo.pdf (last visited April 6, 2009).
[11] GA. CODE ANN. § 48-7-29.10 (2007).

In Louisiana, four new tax credits intended to encourage improvements in child care quality, described in the Center's February 2008 update to *Making Care Less Taxing,* took effect in 2008.[12] The credit for individual families, the child care expense credit,[13] is available for expenses for care provided to a child age five and under at a child care facility that is rated two stars or higher on the state's quality rating system (QRS).[14] The credit amount is a percentage of the existing state child care credit, with the percentage increasing as the rating of the child care facility increases. The credit percentages range from 50% for care in a two-star facility to 200% for care in a five-star facility. An eligible family may claim this credit and Louisiana's child care credit, for a maximum combined value of $3,150 ($2,100 for the new child care expense credit and $1,050 for the existing child care credit). Like the existing child care credit, the new quality-based child care expense credit is refundable for families with federal adjusted gross income of $25,000 or less. And for families at that income level, both credits are clearly calculated based on the family's federal CADC credit before it is limited by the family's federal tax liability. For families with federal adjusted gross income above $25,000, both credits are clearly calculated based on the family's federal CADC credit actually received, after it has been limited by federal tax liability.[15]

In Oklahoma, as described in the Center's February 2008 update to *Making Care Less Taxing*, changes made to the tax code that took effect in 2008 require families to choose between the existing Oklahoma child care credit and a new child tax credit, "whichever amount is greater," and provide that neither credit is available if the family's federal adjusted gross income (AGI) is over $100,000.[16] The Oklahoma child care credit is equal to 20% of the federal "credit for child care expenses allowed,"[17] for a maximum value of $210 for one child and $420 for two or more children. The new Oklahoma child credit is equal to 5% of the federal CTC "allowed,"[18] for a maximum value of $50 per child. Neither credit is refundable and if Oklahoma adjusted gross income is less than federal adjusted gross income, both credits are prorated based on the ratio of Oklahoma adjusted gross income to federal adjusted gross income.

With respect to Oklahoma's child care credit, the instructions to the state tax form for tax year 2008 resolve the meaning of "allowed" by directing the tax filer to apply the state percentage to the amount of the federal CADC credit after it is reduced by federal tax liability. In the above example, this would result in a state child care credit of only $20. Because the instructions direct

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[12] To the extent these credits are claimed against franchise tax, they do not take effect until tax year 2009.
[13] LA. REV. STAT. ANN. § 47:6104 (2008).
[14] Louisiana's QRS, which was established by regulations of the Louisiana Department of Social Services issued in December 2007, evaluates and rates the quality of child care facilities in ascending levels ranging from one to five, designated by "stars," with the fifth level and star representing the highest rating. 33 La. Reg. 2783 (Dec. 2007). Thus far the QRS applies only to child care centers.
[15] The other three Louisiana tax credits, which are described in more detail in the Center's February 2008 update to *Making Care Less Taxing,* are available to the following groups: (1) child care providers participating in the QRS, *see* LA. REV. STAT. ANN. § 47:6105 (2008), (2) businesses that support child care facilities participating in the QRS and resource and referral agencies, *see* LA. REV. STAT. ANN. § 47:6107(A)(1) (2008), and (3) directors and staff working in child care facilities participating in the QRS, *see* LA. REV. STAT. ANN. § 47:6106 (2008). For all of these credits, the amount of the credit depends upon the quality rating of the child care facility.
[16] OKLA. STAT. tit. 68, § 2357(B)(2) (2008).
[17] It is unclear from the Oklahoma statute and forms for tax year 2008 whether care expenses other than for children are eligible for this credit.
[18] The federal CTC generally provides families a tax credit of $1,000 for each qualifying child under age 17, subject to certain income limitations. I.R.C. § 24 (a)-(c) (2008).

the tax filer to apply the state percentage to both the refundable and nonrefundable portions of the federal CTC, however, the state child credit's value is not reduced by federal tax liability.

Changes to Federal Law

The definition of "qualifying child" that applies generally for the federal dependency exemption, EITC, CTC, and CADC credit, was amended as part of the Fostering Connections to Success and Increasing Adoptions Act of 2008,[19] effective in tax year 2009. Specifically, the law provides that, to meet the definition of "qualifying child," an individual

1) must be "younger than the taxpayer claiming such individual;"

2) must not have filed a joint return with the individual's spouse "other than only for a claim of refund;"

3) for purposes of the CTC, be an individual "for which the taxpayer is allowed a deduction under section 151;"[20] and

4) in a case in which the parents of an individual may claim the individual as a "qualifying child" but no parent so claims the individual, the individual may be claimed by another tax filer only if the adjusted gross income of that filer is higher than the "highest adjusted gross income of any parent" of the individual.

These changes to the law were designed to prevent situations in which parents ineligible for various child-related tax credits because of their income permit low-income family members to claim these credits, or claim them for children who are married. However, the changes have little application to claims for the federal CADC credit because a "qualifying child" for this credit must be under the age of 13 and therefore is usually younger than the tax filer incurring the care expenses as well as unlikely to be married. In addition, because the tax filer must have work-related care expenses for the child in order to claim the CADC credit, the filer claiming the credit is likely to be a parent or an individual with an adjusted gross income that is higher than any parent.

Final IRS Regulations on the Definition of a Custodial Parent

The federal CADC credit requires that a divorced, separated, or never-married parent be a child's "custodial parent" in order to claim the credit.[21] The "custodial parent" is defined as "the parent having custody for the greater portion of the calendar year,"[22] and the "noncustodial parent" as "the parent who is not the custodial parent."[23]

[19] Fostering Connections to Success and Increasing Adoptions Act, Pub. L. No. 110-351, § 501, 122 Stat. 3949, 3979-80 (2008) (to be codified at 26 U.S.C. §§ 24, 152), *available at* http://frwebgate.access.gpo.gov/cgi-bin/getdoc.cgi?dbname=110_cong_bills&docid=f:h6893enr.txt.pdf (last visited April 6, 2009).
[20] Section 151 of the Internal Revenue Code authorizes tax filers to take an exemption for dependents. IRC § 151(c) (2008).
[21] IRC § 21(e)(5) (2008). *See also* IRC § 152(e)(2)-(3) (2008).
[22] IRC § 152(e)(4)(A) (2008).
[23] IRC § 152(e)(4)(B) (2008).

In July 2008, the Internal Revenue Service published final regulations, effective in tax year 2009,[24] that further define "custodial parent" as the parent with whom the child resides for the greater number of nights during the calendar year and provide guidance on how to apply this rule.[25] The regulations also clarify that "custody" means "physical custody."[26]

The Center's Tax Credits Outreach Campaign for Tax Year 2008

Each year, the Center conducts a national Tax Credits Outreach Campaign in partnership with state child care advocates to help families take advantage of federal and state child and dependent care tax provisions and other valuable tax benefits. In addition to the Center's campaign partners who are working intensively in several states – including California, Iowa, Minnesota, New Mexico, New York, Ohio, and Oregon – many advocates across the country are working to get the word out to families through child care services and other networks, the media, large employers, and state agencies. In previous years, campaigns in the states have increased significantly the number of families claiming these tax benefits.

To help with these campaigns, the Center prepared materials to inform families about the benefits available for tax year 2008 from the federal CADC care credit, EITC, and CTC, including fliers that are available in English and Spanish, and in some instances, in Vietnamese and Chinese. The Center also prepared state-specific fliers in English and Spanish for every state that has a child and dependent care tax provision, and a variety of other informational and campaign materials. If you have not yet made use of these materials to get the word out to your networks, please consider doing so in these final days of the tax filing season before April 15.

To find out more about how you can spread the word about valuable federal and state tax benefits, check out the Center's Toolkit for Child Care Advocates, and download fliers and other materials for your state from www.nwlc.org/loweryourtaxes. Please contact Amy Matsui at amatsui@nwlc.org with any questions.

Conclusion

For more information about state and federal tax credits for which families may be eligible, please visit http://www.nwlc.org/loweryourtaxes and http://www.nwlc.org/educationseries/. Center staff would be happy to work with you to establish or expand a child care tax provision in your state, improve state tax forms to make it easier for families to claim the credit, or connect with tax credits outreach campaigns in your area. Please contact Amy Matsui at amatsui@nwlc.org for more information.

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[24] Dependent Child of Divorced or Separated Parents or Parents Who Live Apart, 73 Fed. Reg. 37,797-02, 37,801 (July 2, 2008) (to be codified at 26 C.F.R. § 1.152-4).

[25] Dependent Child of Divorced or Separated Parents or Parents Who Live Part, 73 Fed. Reg. at 37,801 (to be codified at 26 C.F.R. § 1.152-4 (d)).

[26] Dependent Child of Divorced or Separated Parents or Parents Who Live Part, 73 Fed. Reg. at 37,801 (to be codified at 26 C.F.R. § 1.152-4 (c)).