NATIONAL WOMEN'S LAW CENTER
EXPANDING THE POSSIBILITIES

**The Expanded Child and Dependent Care Tax Credit in the Family Tax Relief Act of 2009 Would Help Make Child Care More Affordable for Millions of Families**

The federal Child and Dependent Care Tax Credit helps parents afford the child care they need to be productive at work while their children develop the skills they need to succeed in school. In 2007, the credit provided $3.5 billion in child care assistance to 6.5 million families.[1] Although paying for child care takes a larger bite out of the budget of lower-income families than higher-income families,[2] millions of lower-income families can receive little or no benefit from the current credit because of some of its features. In 2007, only 15% of the credit's tax benefits went to the 47% of tax filers with adjusted gross income (AGI) of $30,000 or less, while 27% of the tax benefits went to the 13% of tax filers with AGI above $100,000.[3]

**The federal Child and Dependent Care Tax Credit** is designed to offset a percentage of a family's eligible employment-related child and dependent care costs. Expenses are limited to $3,000 for one, and $6,000 for two or more, children or dependents. The credit has a sliding income scale: lower-income families can claim a higher percentage of expenses than higher-income families. Families with AGI of $15,000 or less can claim 35% of eligible expenses, for a maximum potential credit of $2,100. The percentage phases down as AGI increases to the minimum 20% of expenses for families with AGI above $43,000, for a maximum credit of $1,200. But, because the credit is non-refundable, it is not available to families who do not have federal income tax liability.[4] Therefore, lower-income families, who in theory are eligible for the largest credit, may receive little or none of its benefit, as Table 1 illustrates. In addition, the credit's expense limits and sliding income scale are not indexed for inflation, so the real value of the credit, especially for lower-income households, erodes over time.[5]

**The Family Tax Relief Act of 2009, S. 997, sponsored by Senators Blanche Lincoln (D-AR) and Olympia Snowe (R-ME), would improve the federal Child and Dependent Care Tax Credit for millions of families, especially the low- and moderate-income families who most need help obtaining affordable, high-quality child care.** It also would allow an increase in employer-provided dependent care benefits. Under S. 997:

- **The credit would be fully refundable**. This change would enable *over 1.6 million additional families* to claim the credit for the first time[6] and increase benefits for many others who currently receive only partial benefits, as Table 1 illustrates.

- **The percentage of expenses that could be claimed would increase for low- and moderate-income families.** The maximum percentage of expenses would increase to 50%. The percentage would not start to decrease until AGI exceeded $30,000, and would phase down to 20% for families with AGI above $59,000. This would allow families with AGI of $59,000 or less to claim a higher percentage of expenses than under current law.

- **Expense limits would be increased.** Expense limits would be increased to $5,000 for one, and $10,000 for two or more, children or dependents. This would raise the expense limits nearly to the level they would have reached if the original credit limits had been indexed for inflation.[7] This would benefit families at all income levels whose expenses exceed the current limits.

- **The expense limits and sliding income scale would be adjusted for inflation.** Indexing the expense limits is important because child care costs have been rising faster than overall inflation.[8] Indexing the sliding income scale preserves the targeting of the credit to lower-income families.

- **The exclusion limit for employer-provided dependent care benefits would increase.** Currently, employers can provide, or allow their employees to set aside, up to $5,000 per year in tax-free child and dependent care benefits for one or more children or dependents. This would increase to $7,500 for one child or dependent, and $10,000 for two or more children or dependents, and be indexed for inflation.

- **Table 1: Effect of Expanded Child and Dependent Care Credit on Sample Families, 2009**

| Adjusted Gross Income | Current law – potential | Current law – actual | S. 997 | Current law – potential | Current law – actual | S. 997 |
|---|---|---|---|---|---|---|
| | *Head of household, one child* | | | *Head of household, two children* | | |
| **$15,000** | $1,050 | $0 | $2,500 | $2,100 | $0 | $5,000 |
| **$30,000** | $810 | $810 | $2,500 | $1,620 | $1,070 | $5,000 |
| **$60,000** | $600 | $600 | $1,000 | $1,200 | $1,200 | $2,000 |
| | *Married, one child* | | | *Married, two children* | | |
| **$15,000** | $1,050 | $0 | $2,500 | $2,100 | $0 | $3,750 |
| **$30,000** | $810 | $765 | $2,500 | $1,620 | $400 | $5,000 |
| **$60,000** | $600 | $600 | $1,000 | $1,200 | $1,200 | $2,000 |

Assumptions: All income is from earnings; families incur the maximum amount of allowed expenses; earnings of married couples are divided equally between spouses; all families claim the standard deduction, Child Tax Credit, and Earned Income Tax Credit if eligible; and tax filers are not subject to the Alternative Minimum Tax.

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[1] Internal Revenue Service, Statistics of Income, Preliminary Data for Tax Year 2007, Table 1: Individual Income Tax Returns, Selected Income and Tax Items by Size of Adjusted Gross Income, available http://www.irs.gov/pub/irs-soi/07in01pl.xls (last visited 8/21/09)[IRS Statistics of Income].

[2] Families with incomes below the poverty line who pay for child care spend, on average, 32% of their incomes on child care, compared to 15% percent for families with incomes between 100% and 200% of poverty, and 6% for families with incomes at or above 200% of poverty. U.S. Census Bureau, "Who's Minding the Kids? Child Care Arrangements: Summer 2006, Detailed Tables," Table 6: Average Weekly Child Care Expenditures of Families with Employed Mothers that Make Payments, by Age Groups and Selected Characteristics: Summer 2006, available online at http://www.census.gov/population/socdemo/child/table-2006/tab06.xls (last visited 8/24/09).

[3] Calculations by NWLC from IRS Statistics of Income, Table 1, *supra* note 1.

[4] The Economic Growth and Tax Relief Reconciliation Act (EGTRRA) of 2001 adjusted several parameters of the credit for the first time in 20 years. It raised the expense limits from $2,400 for one, and $4,800 for two or more children or dependents to $3,000 and $6,000 respectively; increased the maximum percentage of eligible expenses from 30% to 35%; and raised the income level for the maximum credit from $10,000 to $15,000. But it did not make the credit refundable or index the expense limits and sliding scale. The EGTRRA changes took effect in tax year 2003 and will expire after tax year 2010 unless extended.

[5] Without indexing, a family whose income has risen by no more than inflation could find that both the value and percentage of expenses they can claim for the credit has declined, even though their income has not risen in real terms.

[6] Jeffrey Rohaly, Tax Policy Center, "Reforming the Child and Dependent Care Credit," June 2007, *available at* http://www.taxpolicycenter.org/UploadedPDF/411474_child_tax.pdf (last visited May 28, 2008)(estimating that an additional 1.6 million households would have been able to claim the credit if it had been made refundable in 2006).

[7] If the expense limits of $2,400 and $4,800 had been indexed for inflation when they were established in 1981, they would be $5,336 and $10,712 in 2009. NWLC calculations using the CPI-U.

[8] Between 2002 and 2008, child care costs grew 30%, while the overall inflation rate was 20%. NWLC calculations using the CPI-U.