Making Care *Less* Taxing

Improving State Child and Dependent Care Tax Provisions

22	Enter your **standard deduction** (see left margin).		2
23	Subtract line 22 from line 20. If line 22 is more than line 20 [illegible] 0-.		2
24	Multiply $2,900 by the total number of exemptions claim[illegible] ne 6d.		2
25	Subtract line 24 from line 23. If line 24 is more than line [illegible] ter -0-. This is your **taxable income.** ►		2
26	**Tax,** including any alternative minimum tax (see pa[illegible]).		2
27	Credit for child and dependent care expenses. Attach Schedule 2.	27	
28	Credit for the elderly or the disabled. Attach Schedule 3.	28	
29	Education credits. Attach Form 8863.	29	
30	Rate reduction credit. See the worksheet on page 36.	30	
31	Child tax credit (see page 36).	31	
32	Adoption credit. Attach Form 8839.	32	
33	Add lines 27 through 32. These are your **total credits.**		3
34	Subtract line 33 from line 26. If line 33 is more than line 26, enter -0-.		3

April 2006

NATIONAL WOMEN'S LAW CENTER
EXPANDING THE POSSIBILITIES

The National Women's Law Center is a non-profit organization that has been working since 1972 to advance and protect women's legal rights. The Center focuses on major policy areas of importance to women and their families, including employment, education, reproductive rights and health, and family economic security — with special attention given to the needs of low-income women. Nancy Duff Campbell, the principal author of this report, is Co-President, Joan Entmacher is Vice-President for Family Economic Security, Cristina Martin Firvida and Amy K. Matsui are Senior Counsels, and Christie Love is a Fellow of the National Women's Law Center. The authors wish to acknowledge and thank National Women's Law Center Senior Policy Analyst Karen Schulman, Policy Fellow Amy Meek, and former National Women's Law Center Counsel Kimberly Glassman, for their research assistance in preparing this report, and Executive Assistant Amy Gawad for her production assistance. The authors also wish to thank the generous funders whose financial support made this report possible: the Annie E. Casey Foundation, Nathan Cummings Foundation, Ford Foundation, George Gund Foundation, Georgetown Law and Public Policy Program, McKnight Foundation, Moriah Fund, David and Lucile Packard Foundation, William Penn Foundation, Skadden Fellowship Foundation, and an anonymous donor.

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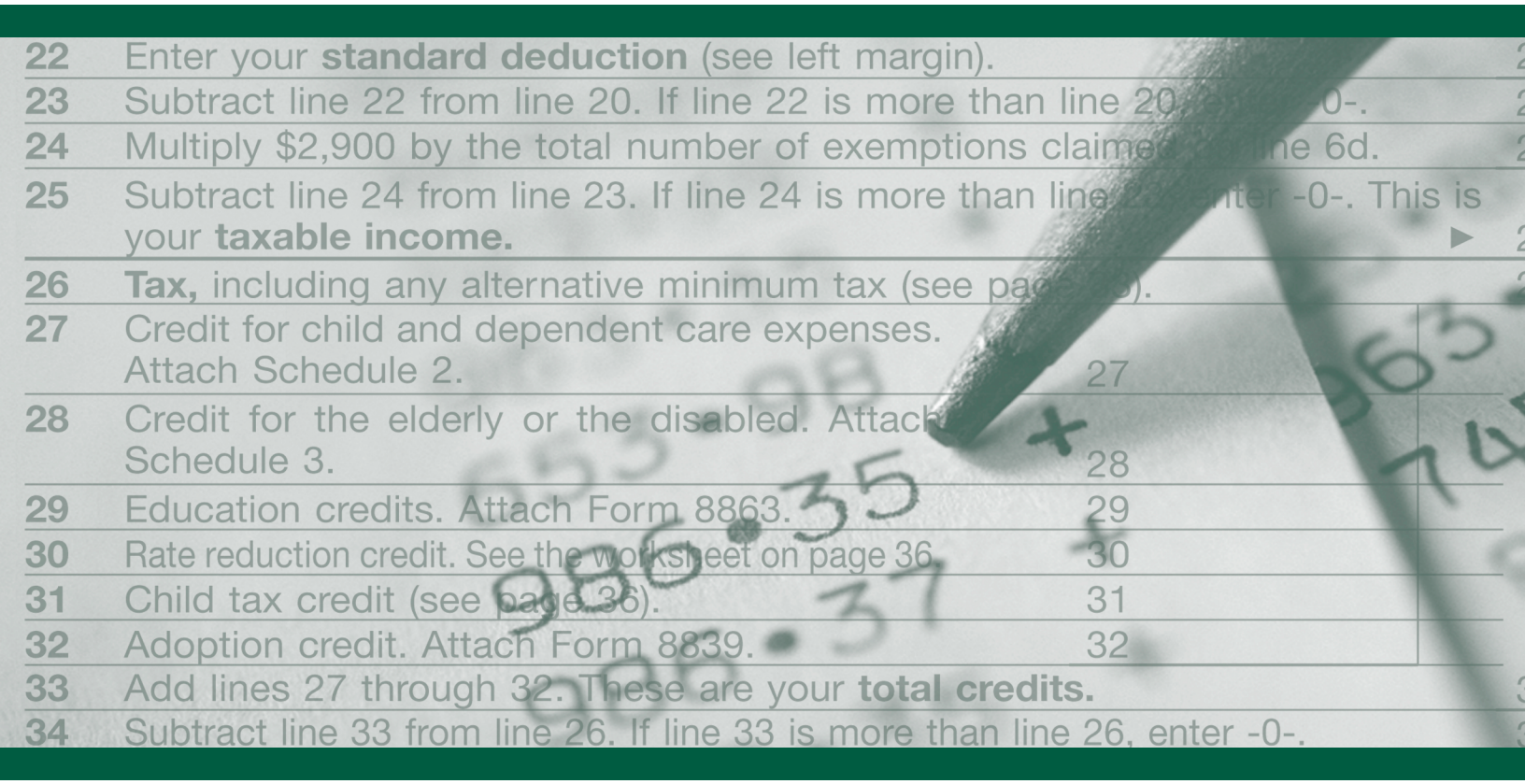
Making Care *Less* Taxing

Improving State Child and Dependent Care Tax Provisions



22	Enter your **standard deduction** (see left margin).		
23	Subtract line 22 from line 20. If line 22 is more than line 20, enter -0-.		
24	Multiply $2,900 by the total number of exemptions claimed on line 6d.		
25	Subtract line 24 from line 23. If line 24 is more than line 23, enter -0-. This is your **taxable income.** ►		
26	**Tax,** including any alternative minimum tax (see page 35).		
27	Credit for child and dependent care expenses. Attach Schedule 2.	27	
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Nancy Duff Campbell, Joan Entmacher, Amy K. Matsui
Cristina Martin Firvida, Christie Love

April, 2006

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Making Care Less Taxing

Improving State Child and Dependent Care Tax Provisions

Paying for care for children or adult dependents takes a big bite out of many families' already limited budgets. Yet without such care, married-couple and single-parent families alike have difficulty entering or remaining in the labor force. As a result, families across the country are caught in a bind: finding the financial resources to pay for the child and dependent care necessary for them to earn a living. The tax codes of the federal government and over half the states provide some assistance to families in meeting their employment-related care expenses. However, many states provide little or no tax assistance to families struggling to pay for the care that is so essential to their economic wellbeing.

The tax codes of the federal government and over half the states provide some assistance to families in meeting their employment-related care expenses.

This report is designed to help state policy makers and advocates rectify this situation and assist them in developing the best child and dependent care (CADC) income tax provisions possible for their states.[1] By analyzing and evaluating tax policies relating to care for children and adult dependents, this report can help states lacking such provisions enact them, and help other states improve CADC provisions already on the books. The report reviews the reasons supporting enactment of CADC tax provisions; describes the federal child and dependent care tax credit, which serves as the basis for many state provisions; and provides an overview of the state CADC tax provisions in effect for

[1] This report examines only state tax credits or deductions for child and dependent care expenses that are incurred in order for the tax filer (and the tax filer's spouse, if married) to be gainfully employed or actively look for gainful employment. A few states provide tax credits for a portion of expenses incurred for in-home or out-of-home care or other services for a child or an aged or disabled dependent without regard to whether the expenses are employment-related. Several states provide tax credits, deductions, additional exemptions, or additional standard deductions for tax filers with children and/or aged or disabled dependents that are calculated without regard to the amount of any expenses the tax filer may have incurred and without regard to whether the expenses are employment-related. And finally, some states provide credits or deductions for low-income tax filers, often limited to tax filers with children, that are also calculated without regard to the amount of any expenses the tax filer may have incurred and without regard to whether the expenses are employment-related. All of these provisions are beyond the scope of this report and not referenced further unless their calculation in some way relates to the calculation of a state's employment-related child and dependent care credit or deduction.

tax year 2005.[2] Finally, the report identifies policy decisions commonly made when enacting and implementing CADC income tax provisions and makes recommendations designed to help policy makers and advocates identify and pursue the best decisions for families.

I. Policies Served by Child and Dependent Care Tax Provisions

There are a number of good reasons to adopt CADC income tax provisions.

- **Assistance for Families with Large Employment Expenses:** Many families have employment-related care expenses[3] that put a severe strain on the family budget. The average fee for full-time, center-based child care today ranges from over $3,000 to over $13,000 annually, depending on geographic location and whether the care is for an infant or preschool-age child.[4] Indeed, for families with a child between the ages of three and five, child care represents the second or third greatest expense[5]. Employ-

[2] When applicable, changes in the provisions scheduled for later tax years are also noted.

[3] Fifty-four percent of families with employed mothers whose youngest child is under age five, and twenty-six percent of families with employed mothers whose youngest child is age five to fourteen, pay for child care. Julia Overturf Johnson, Bureau of the Census, U.S. Dep't of Commerce, Current Population Report, No. P70-101, Who's Minding the Kids? Child Care Arrangements Winter 2002, Table 6 (2005), *available at* http://www.census.gov/prod/2005pubs/p70-101.pdf (last visited Mar. 17, 2006) [hereinafter Who's Minding the Kids?]. (The report only provides breakouts by income, age of child, and other subcategories for families based on whether the mother was employed, not on whether the father was employed.) Although there are not reliable data on the number of individuals in the labor force with dependents unable to care for themselves, in one study 35% of employed individuals (both men and women) reported that they had cared for a relative or in-law age sixty-five or older in the past year. James T. Bond *et al.*, Families & Work Institute, National Study of the Changing Workforce: Executive Summary 2002, at 2 (2003).

[4] National Association of Child Care Resource & Referral Agencies (NACCRRA), Breaking the Piggy-Bank: Parents and the High Price of Child Care App. A: Detailed Table 1 (2006) [hereinafter Breaking the Piggy Bank]. The NACCRRA study, based on data collected in 2005 from child care resource and referral networks or agencies in all fifty states, *id.* at 27, found that the average annual fee for full-time, center-based care for a four-year-old child ranged from $3,016 in Alabama to $9,628 in Massachusetts; the average fee was below $4,000 in only seven states (Alabama, Arkansas, Mississippi, Missouri, Nevada, Oklahoma, and West Virginia), *id.* at App. A: Detailed Table 1. The average annual fee for full-time, center-based care for an infant ranged from $3,803 in Alabama to $13,480 in Massachusetts; the average fee was above $4,000 in every state except Alabama. *Id.* Based on more limited data collected from local child care resource and referral agencies, the study found that the average annual fee for full-time, family child care ranged from $2,080 to $8,761 for care for a preschool-age child and from $2,236 to $13,100 for care for an infant. *Id.* at 7.

[5] Mark Lino, Center for Nutrition Policy & Promotion, U.S. Dep't of Agriculture, Expenditures on Children by Families, 2004, Tables 1 & 7 (2005), *available at* http://www.cnpp.usda.gov/Crc/crc2004.pdf (last visited Mar. 17, 2006). Child care is the second-greatest expense (after housing) for two-parent families with a child age three to five, *id.* at Table 1, and the third greatest expense for single-parent families with a child age three to five (after housing and food for low-income, single-parent families, and after housing and transportation for moderate-income, single-parent families), *id.* at Table 7. Depending on income, families with employed mothers that pay for care for children under age fifteen spend an average of 6 to 24% of their income on child care. Who's Minding the Kids?, *supra* note 3. Families with annual income of $54,000 and over spend an average of 5.8% of their income on child care and families with annual income of less than $18,000 spend an average of 24.4% of their income on child care. *Id.* Age of children is also a factor in the amount families spend on child care. Families with employed mothers that pay for care for children under age five spend an average of 9.5% of their income on child care and families with employed mothers that pay for care for children ages five to fourteen spend an average of 4.4% of their income on child care. *Id.*

ment-related care expenses for adult dependents can also be very high. The average fee for full-day, adult day care is $46 a day, or $11,960 a year.[6] Many families simply do not have the financial resources to pay for care of children or adult dependents; as a result, the cost of employment-related care keeps many individuals out of the job market.

- **Equitable Income Tax Treatment of Families:** Treating tax filers according to their ability to pay is a cornerstone of tax fairness. A family that earns $30,000 a year but must spend over $3,000 for child care in order to earn that income has less available income than a family that earns $30,000 and has no employment-related care expenses. Because employment-related care expenses can cut deeply into a family's income, CADC tax provisions recognize that a family with such expenses should pay less tax than a family with the same income but no employment-related care expenses. The federal tax code recognizes a number of large, employment-related expenses — such as office furnishings, automobiles used in a trade or business and business meals and entertainment — and excludes them, or a portion of them, from taxed income. CADC tax provisions apportion tax liability more equitably among families and embody the important principle that employment-related care expenses are a genuine cost of earning income.
- **Higher-Quality Care:** All children and adults unable to care for themselves need care that protects their well-being and promotes their development. Such higher-quality care costs families more money.[7] These care payments go toward making facilities safe and providing activities, equipment, and staff ratios that promote children's and adults' development. These payments also help child and adult care programs pay the

Average fees for full-time, center-based child care range from over $3,000 to over $13,000 annually.

[6] Wake Forest University School of Medicine, National Study of Adult Day Services: Adult Day Center Survey 2001-2002 (2002) [hereinafter National Study of Adult Day Services], *available at* http://www.rwjf.org/files/newsroom/adultdayPowerPt1.ppt#760,45,Top Private Pay, Undiscounted Fees (last visited on Mar. 23, 2006) (annual cost calculated by the National Women's Law Center from daily cost assuming care is used five days a week for fifty-two weeks a year). Adult day care programs generally provide health, social, personal care, and related support services for functionally or mentally impaired adults.

[7] For example, a comparison of accredited and non-accredited care costs in fifteen zip code areas in low-income urban areas found that accredited centers had a higher average fee for infant care than non-accredited centers in eleven of the areas; in these eleven areas, the average annual fee for accredited infant care was $156 to $4,056 (2% to 45%) higher than the average annual fee for non-accredited care. Breaking the Piggy Bank, *supra* note 4, at App. A: Detailed Table 4 (calculations of percentage difference by the National Women's Law Center based on average costs). Accredited centers also had a higher average fee for preschool care than non-accredited centers in twelve of the areas; in these twelve areas, the average annual fee for accredited preschool care was $52 to $5,244 (1% to 90%) higher than the average annual fee for non-accredited preschool care. *Id.*

wages needed to attract and retain well-qualified staff.[8] Tax code provisions that put more money in families' hands for employment-related care expenses help them to purchase better care for their children and other dependents.

- **Equity for Women:** Women continue to bear the bulk of responsibility for care of children and adult dependents. Tax code provisions that assist women in paying for care for children and adult dependents take some of the burden off women and lessen barriers to women's participation in the workforce, enabling them to support themselves and their families.[9] Assistance with employment-related care is especially important for single mothers, who are more likely to be poor than married couples or single fathers.[10] In addition, by enabling families to pay more for care, CADC

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[8] Several studies suggest a link between low salaries and high turnover rates among child care staff. For example, a study of child care centers in California revealed that the average turnover rate between 1999 and 2000 was 30% for all teaching staff. Marcy Whitebook *et al.*, Center for the Child Care Workforce, Then and Now: Changes in Child Care Staffing 1994-2000, at v (2001) [hereinafter Then and Now 1994-2000]. Teaching staff who had left their jobs said that improving wages and benefits would reduce turnover rates at their former centers and in the child care field. *Id.* at vi. The average salary for teachers was $24,606 per year. *Id.* In a survey of North Carolina child care centers, 22% of the teachers planned to leave the child care field in three years. Child Care Services Association & FPG Child Development Institute, Working in Child Care in North Carolina: The North Carolina Child Care Workforce Survey 2003, at 20 (2004), *available at* http://www.fpg.unc.edu/~NCNR_Assessment/pdfs/2003WFReport.pdf (last visited Mar. 17, 2006). Over three-quarters (78%) of these teachers said that higher earnings would motivate them to stay. *Id.*

[9] Just over 70% of American women with children under eighteen — 77% of women with children ages six to seventeen, 62% of women with children under age six, and 53% of women with children under age one — are in the paid labor force. Bureau of Labor Statistics, U.S. Dep't of Labor, Employment Characteristics of Families in 2004, Current Population Survey, Tables 5 & 6 (2005), *available at* http://www.bls.gov/news.release/pdf/famee.pdf (last visited Mar. 17, 2006). (These percentages understate how many women raising children are in the paid labor force because they reflect only women raising their *own* children, and do not include the many women who are raising grandchildren, nieces and nephews, or other related children.)

[10] For 2004, the median income of families with children headed by a woman (with no husband present) was $23,428, well below the median income of $36,394 of families with children headed by a man (with no wife present) and the median income of $67,898 of married-couple families with children. The median income of families with children headed by a black ($20,517) or Hispanic ($19,711) woman (with no husband present) is even lower than that for all families headed by a woman (with no husband present). Bureau of the Census, U.S. Dep't of Commerce & Bureau of Labor Statistics, U.S. Dep't of Labor, Detailed Income Tabulations from the Current Population Survey, 2005 Annual Social and Economic Supplement, Table FINC-03: Presence of Related Children Under 18 Years Old-All Families, By Total Money Income in 2004 (2005), *available at* http://pubdb3.census.gov/macro/032005/faminc/toc.htm (last visited Mar. 17, 2006). Moreover, 37.2% of individuals in families with children headed by a woman (with no husband present) were poor in 2000, compared to 17.3% of individuals in families with children headed by a man (with no wife present) and 7.8% of individuals in married-couple families with children. Bureau of the Census, U.S. Dep't of Commerce & Bureau of Labor Statistics, U.S. Dep't of Labor, Detailed Poverty Tabulations from Current Population Survey, 2005 Annual Social and Economic Supplement, Table POV03: People in Families with Related Children Under 18 by Family Structure, Age, and Sex: 2004 (2005), *available at* http://pubdb3.census.gov/macro/032005/pov/new03_000.htm (last visited Mar. 17, 2006). The poverty rate for individuals in families with children headed by a black (45.0%) or Hispanic (45.1%) woman (with no husband present) is even higher than that for individuals in all families headed by a woman (with no husband present). *Id.*

tax provisions can raise the income of child and dependent care workers, who are mostly women and are grossly underpaid.[11]

II. The Federal Child and Dependent Care Tax Credit

The federal tax code has had a child and dependent care tax credit since 1976.[12] The credit permits a tax filer with employment-related child and dependent care expenses to subtract a portion of these expenses from federal tax liability to reduce the amount of tax actually owed the federal government. The federal credit is important to state CADC tax provisions for two reasons. First, most states' CADC tax provisions are tied to the federal credit, using some or all of the provisions of the federal credit to determine the state tax benefit. Second, the federal credit can serve as a model for states to develop CADC tax provisions that are independent of the federal provision.

The federal child and dependent care tax credit is one of the largest sources of federal child care assistance.

The federal credit has the following key features:

- **The credit covers employment-related expenses for both children and adult dependents.** The federal credit covers employment-related expenses[13] for the care of a dependent child under the age of thirteen who

[11] The child care workforce is 98% female. Center for the Child Care Workforce, Current Data on Child Care Salaries and Benefits in the United States 3 (2002), *available at* http://www.ccw.org/pubs/2002Compendium.pdf (last visited Mar. 17, 2006). A significant proportion of child care providers are women of color. A study of early childhood programs for three-and four-year-olds across the United States found that almost one-quarter of child care teachers are women of color. Gitanjali Saluja, Diane M. Early, & Richard M. Clifford, *Demographic Characteristics of Early Childhood Teachers and Structural Elements of Early Care and Education in the United States*, 4 Early Childhood Research & Practice 4 (2002), *available at* http://ecrp.uiuc.edu/v4n1/saluja.html (last visited Mar. 23, 2006). Similarly, a study of child care centers in California showed that more than one-third of child care workers are women of color. Then and Now 1994-2000, *supra* note 8, at 22. In 2004, the most recent year for which data are available, the average annual wage for a child care worker was $18,060. Bureau of Labor Statistics, U.S. Dep't of Labor, November 2004 National Occupational Employment and Wage Estimates, Personal Care and Service Occupations, *available at* http://www.bls.gov/oes/current/oes_39Pe.htm (last visited Mar. 17, 2006). Child care workers earn less annually than costume attendants ($28,220), barbers ($25,470), and even pet sitters ($19,620). *Id.*

[12] The origin of the credit was a 1954 provision establishing a tax deduction for certain employment-related child and dependent care expenses. Act of Aug. 16, 1954, Pub. L. No. 83-591, §214, 68A Stat. 3, 70-71 (codified at I.R.C. §214 (1954)). The deduction was converted to a credit in 1976. Tax Reform Act of 1976, Pub. L. No. 94-455, §504, 90 Stat. 1520, 1563-66 (codified at I.R.C. §44A (1976)). The current federal CADC credit is found at I.R.C §21 (2005).

[13] Employment-related expenses are expenses incurred to enable the tax filer to be gainfully employed. I.R.C. §21(b)(2)(A) (2005). If the tax filer is married, the expenses must also be incurred to enable the tax filer's spouse to be gainfully employed, unless the spouse is a full-time student or incapable of self-care. *See* I.R.C. §21(d)(1) (2005).

lives with the tax filer and for the care of a disabled spouse or disabled dependent who lives with the tax filer and is incapable of self-care.[14]

- **The credit covers a range of care options.** The federal credit permits flexibility in care arrangements, covering both in-home and out-of-home care in a variety of settings. However, care for spouses and dependents age thirteen and older who are incapable of self-care is covered only if the spouse or dependent spends at least eight hours a day in the tax filer's household.[15] This prevents families from claiming the credit for care in a residential facility, such as a nursing home. In addition, expenses paid to a "dependent care center," defined as a facility that provides care for more than six individuals, are covered only if the center complies with applicable state and local laws.[16]
- **The credit places a limit on eligible expenses.** A tax filer (and the tax filer's spouse, if married) may claim employment-related expenses of up to $3,000 annually for one child or dependent, and up to $6,000 annually for two or more children or dependents.[17] Any expenses above these amounts are not eligible for the credit. In addition, the expenses may not exceed the earned income of the tax filer or the tax filer's spouse, whichever is less.[18]
- **The credit targets the greatest amount of assistance to lower-income families.** A tax filer may claim only a portion of eligible expenses as a credit, the portion dropping on a sliding scale as the tax filer's income

[14] Congress in the Working Families Tax Relief Act of 2004, which took effect in tax year 2005, added a requirement for the CADC credit that a child under the age of thirteen must live with the tax filer for more than half the year, and eliminated the former requirement that the tax filer must provide over half of the child's support. (However, expenses for a child who provides over one-half of his or her own support do not qualify for the credit.) Congress retained the requirement that the tax filer must provide over half of the support for a disabled dependent (other than a spouse), and added a requirement that a disabled dependent (and a spouse) must live with the tax filer for more than half the year. *See* Working Families Tax Relief Act of 2004, Pub. Law No. 108-311, §203, 118 Stat. 1166, 1175 (codified as amended at I.R.C. §§21(a)1), 21(b)(1) & 21(e)(1) (2005)) [hereinafter WFTRA].

[15] I.R.C. §21(b)(2)(B)(ii) (2005).

[16] I.R.C. §21(b)(2)(C) & (D) (2005).

[17] I.R.C. §21(c) (2005). Congress increased these expense limits from $2,400 for one child or dependent and $4,800 for two or more children or dependents in the Economic Growth and Tax Relief Reconciliation Act, Pub. L. No. 107-16, §204, 115 Stat. 38, 49 (2001) (codified as amended at I.R.C. §21(c) (2005)) [hereinafter EGTRRA]. These changes took effect in tax year 2003 but, unless extended, expire after tax year 2010. *Id.* at §901.

[18] I.R.C. §21(d)(1) (2005). Individuals who participate in a dependent care assistance program sponsored by their employer must subtract any child or dependent care assistance received through that program from the CADC expenses they can use to claim the federal CADC credit. I.R.C. §21(c) (2005). Employers may provide their employees with up to $5,000 in tax-free CADC assistance through a dependent care assistance program. I.R.C. §129 (2005).

rises, from 35% for tax filers with adjusted gross income (AGI) of $15,000 or less to 20% for tax filers with AGI above $43,000.[19] The following chart illustrates the maximum credit amounts at different income levels:

Federal Child and Dependent Care Credit Rates and Maximum Amounts, Tax Year 2005

Adjusted Gross Income	Percent of Expenses Credited	One Child/ Dependent	Two or More Children/ Dependents
$0–$15,000	35%	$1,050	$2,100
$15,001–$17,000	34%	$1,020	$2,040
$17,001–$19,000	33%	$990	$1,980
$19,001–$21,000	32%	$960	$1,920
$21,001–$23,000	31%	$930	$1,860
$23,001–$25,000	30%	$900	$1,800
$25,001–$27,000	29%	$870	$1,740
$27,001–$29,000	28%	$840	$1,680
$29,001–$31,000	27%	$810	$1,620
$31,001–$33,000	26%	$780	$1,560
$33,001–$35,000	25%	$750	$1,500
$35,001–$37,000	24%	$720	$1,440
$37,001–$39,000	23%	$690	$1,380
$39,001–$41,000	22%	$660	$1,320
$41,001–$43,000	21%	$630	$1,260
$43,001+	20%	$600	$1,200

The maximum federal credit is $2,100.

- **Married couples must file a joint return to be eligible for the credit.**[20] This rule does not apply to legally separated married couples, or certain married individuals who are living apart from their spouse and providing over half the cost of maintaining their own home.[21]

The federal CADC credit is one of the largest sources of federal child care assistance.[22] About 6.3 million tax filers claimed the federal CADC credit and received over $3.2 billion in tax benefits in 2003, the most recent year for

[19] I.R.C. §21(a)(2) (2005). Congress in EGTRRA increased the maximum percentage of eligible expenses a taxpayer may claim from 30% of expenses and increased the AGI at and below which a taxpayer may claim the maximum percent of qualifying expenses from $10,000, and the AGI above which a taxpayer may claim the minimum 20% of expenses from $28,000. EGTRRA, *supra* note 17, §204 (codified as amended at I.R.C. §21(a)(2) (2005)). These changes took effect in tax year 2003, but, unless extended, expire after tax year 2010. The effect of these changes was to increase the credit amounts for tax filers with AGI up to $43,000.

[20] I.R.C. §21(e)(2) (2005).

[21] I.R.C. §21(e)(3)-(4) (2005).

[22] *See* Comm. on Ways and Means, U.S. House of Representatives, 108th Congress, 2d Sess., *2004 Green Book* 9-29 (2004), *available at* http://www.gpoaccess.gov/wmprints/green/2004/htm (last visited Mar. 17, 2006).

which data are available.[23] There are, however, a number of features of the federal credit that undermine its value to families with employment-related care expenses, particularly those with lower incomes.

- **The federal credit is not refundable.**[24] This means that families who qualify for a credit that is larger than their tax liability receive only a portion of the credit — up to the amount of tax owed — for which they are eligible. For example, a family that qualifies for a credit of $800 but only owes $200 in taxes will receive a credit of only $200. If the credit were refundable, the family would receive a tax refund of $600. The credit's nonrefundability affects primarily those families who owe relatively little tax — typically families with more limited income whose need for assistance with employment-related care expenses may be the greatest. Families whose income is so low that they owe no tax receive no federal credit at all.

- **Over time, fewer and fewer families receive the benefit of the credit's low-income targeting because the credit is not refundable and because the sliding scale thresholds are not indexed for inflation.** The dollar amounts of basic tax provisions that determine tax liability — for instance, the personal exemption, the standard deduction, and the earned income credit — are all indexed for inflation.[25] The effect of this indexing is to avoid an increase in a family's tax when the only change in its income is the result of inflation. Because the CADC credit's sliding scale thresholds are not indexed for inflation, however, the targeting to lower-income fam-

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[23] Internal Revenue Service, Statistics of Income Bulletin: Fall 2005, at 281, Selected Historical and Other Data, Table 1: Individual Income Tax Returns: Selected Income and Tax Items for Specified Tax Years, 1990-2003.

[24] I.R.C. §26 (2005).

[25] Congress in the Economic Recovery Tax Act of 1981 provided for annual indexing of the personal exemption, standard deduction and tax brackets, beginning in tax year 1985. Economic Recovery Tax Act of 1981, Pub. L. No. 97-34, §104, 95 Stat. 172, 188-90 (1981) (codified as amended at I.R.C. §§151(personal exemption), 63 (standard deduction), 1 (tax brackets) (2005)) [hereinafter ERTA]. In the Tax Reform Act of 1986, Congress provided for annual indexing of the earned income tax credit, beginning in tax year 1987. Tax Reform Act of 1986, Pub. L. No. 99-514, §111, 100 Stat. 2085, 2107-08 (1986) (codified as amended at I.R.C. §32 (2005)). In the Tax Reform Act of 1986, Congress also substantially increased the standard deduction and personal exemption. *Id.* §§102,103 (codified as amended at I.R.C. §§63 (standard deduction), 151 (personal exemption) (2005)). Congress in the Jobs and Growth Tax Relief Reconciliation Act and WFTRA increased the standard deduction for married couples, beginning in tax year 2003 (but, unless extended expiring after tax year 2010). Jobs and Growth Tax Relief Reconciliation Act, Pub. L. No. 108-27, §103, 117 Stat. 752, 754 (codified as amended at I.R.C. §63(c) (2005)) [hereinafter JGTRRA]; WFTRA, *supra* note 14, §101. (In JGTRRA, Congress increased the standard deduction for tax years 2003 and 2004; in WFTRA, Congress extended the JGTRRA increase through tax year 2010, after which, unless extended, it expires.) These increases in the amounts of the standard deduction and personal exemption, which were in addition to the annual indexing of these tax code provisions, have contributed in part to the erosion of the federal CADC credit's value by widening the gap between the income levels at which a family may claim the maximum credit percentages and the income levels at which a family incurs federal income tax liability.

ilies provided by the sliding scale is eroding as fewer and fewer families have incomes low enough to claim the credit's highest percentages of expenses. The EGTRRA increase in the sliding scale that took effect in tax year 2003 (but, unless extended, expires after tax year 2010) ameliorates but does not correct this problem. For example, for tax year 2005, only heads of household with one child or dependent have tax thresholds (the point at which tax liability begins) below $15,000 and are therefore eligible for the highest credit of 35% of their expenses. The tax thresholds for heads of household with two or more children or dependents are above $16,000, and the tax thresholds for all married couples with children or dependents are above $19,000. Thus, no families with two or more children or dependents are eligible for the highest credit of 35% of their expenses and no married couples with children are eligible for a credit higher than 32% of their expenses.[26] Without refundability or indexing of the sliding scale, both the availability of the credit and its low-income targeting will continue to erode over time.

- **The dollar expense limits do not reflect the cost of care.** The recent increase in the expense limits in EGTRRA was the first time the limits had been updated in 20 years. But the new limits of $3,000 for one child or dependent and $6,000 for two or more children or dependents, which are not indexed for inflation,[27] do not reflect the average costs of child care in 2005.[28] Moreover, they are particularly inadequate to cover the high cost of adult day care.[29] As a result, the expense limits of the credit do not reflect many families' actual care expenses.

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[26] If the $10,000 AGI level at and below which tax filers were eligible for the highest percentage of their expenses had been indexed for inflation when the sliding scale was added to the law in 1981 (effective for tax year 1982), *see* ERTA, *supra* note 25, §124 (codified as amended at I.R.C. §21(a)(2) (2005)), it would be $20,238 for tax year 2005 — considerably higher than the $15,000 level set by EGTRRA — and married couples with one child or dependent and single heads of household with up to three children or dependents, because their tax thresholds are below that amount, would be eligible for the maximum credit, currently 35% of their expenses. (Calculations by the National Women's Law Center based on the Consumer Price Index for All Urban Consumers, *available at* http://www.bls.gov/cpi (last visited Mar. 17, 2006).) Moreover, if the increase in that AGI level to $15,000 in EGTRRA expires in 2010, as it is scheduled to do, its reversion to $10,000 will, in combination with the indexing of the Internal Revenue Code's other relevant provisions, make even fewer families eligible for the maximum credit percentages in tax year 2011.

[27] If the expense limits of $2,400 and $4,800 had been indexed for inflation when they were established in 1981 (effective for tax year 1982), *see* ERTA, *supra* note 25, §124 (codified as amended at I.R.C. §21(c) (2005)), they would be $4,857 and $9,714, respectively, for tax year 2005, considerably higher than the limits established in EGTRRA of $3,000 and $6,000, respectively. (Calculations by the National Women's Law Center based on the Consumer Price Index for All Urban Consumers, *supra* note 22.) If even the $3,000/$6,000 limits had been indexed for inflation in EGTRRA, they would be $3,184 and $6,368, respectively, for tax year 2005. Moreover, if the $3,000/$6,000 limits expire in 2010, as they are scheduled to do, the reversion to the prior limits of $2,400 for one child or dependent and $4,800 for two or more children or dependents will be far below the cost of care in tax year 2011.

[28] *See* Breaking the Piggy Bank, *supra* note 4.

[29] *See* National Study of Adult Day Services, *supra* note 6.

III. State Child and Dependent Care Tax Provisions: An Overview

Twenty-seven states (including the District of Columbia) have thirty-one CADC income tax provisions.[30] Over 2.7 million state tax filers claimed these provisions in the most recent year for which data are available, and received over $687 million in tax benefits.[31] These provisions may be credits, which, like the federal credit, are amounts offset against state tax liability to reduce the amount of state tax owed. Or these provisions may be deductions, which reduce the amount of income subject to the state tax and ultimately reduce the amount of state tax owed.

Most state CADC provisions are dependent on or tied to the federal credit, meaning that the tax filer's state credit or deduction is determined by some or all of the provisions of the federal credit. A few states have CADC provisions that are not tied to the federal credit.

- Seventeen states provide a *tax credit whose amount is a percentage of the federal credit*. The states with this type of provision are Arkansas, California, Colorado,[32] Delaware, the District of Columbia, Iowa,[33] Kansas, Kentucky,

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[30] These states are Arkansas, California, Colorado, Delaware, the District of Columbia, Hawaii, Idaho, Iowa, Kansas, Kentucky, Louisiana (two provisions), Maine, Maryland (two provisions), Massachusetts, Minnesota, Montana, Nebraska, New Mexico, New York, North Carolina, Ohio, Oklahoma, Oregon (two provisions), Rhode Island, South Carolina, Vermont (two provisions), and Virginia. (Georgia enacted a new CADC provision in April, 2006, too late to be included in this report; the provision takes effect in tax year 2006.) Fourteen states have a personal income tax but no CADC provision — Alabama, Arizona, Connecticut, Illinois, Indiana, Michigan, Mississippi, Missouri, New Jersey, North Dakota, Pennsylvania, Utah, West Virginia, and Wisconsin. Seven states — Alaska, Florida, Nevada, South Dakota, Texas, Washington, and Wyoming — have no personal income tax and two states — New Hampshire and Tennessee — tax only certain non-wage personal income. Alaska, although it does not have a personal income tax, has statutory authority for a refundable CADC tax credit of 16% of the federal credit, subject to "an appropriation for that purpose," Alaska Stat. §43.20.013 (Michie, WESTLAW through all 2005 Legislation), which has never been made. Telephone Interview with Mike Williams, Chief Economist, Alaska Dep't of Revenue, (Mar. 8, 2006). Appendix B provides statutory citations to the state provisions examined in this report.

[31] Calculations by the National Women's Law Center based on data for tax years 2002 to 2004 (or FY 2005) from state revenue publications and telephone conversations with state revenue officials and, when state data were not available, from calculations based on claims by state residents of the federal CADC credit.

[32] In Colorado, the percentage of the federal credit that a tax filer may claim increases (for at least some tax filers) in tax years in which the amount of revenue for the state fiscal year immediately preceding the tax year exceeded a specified amount, if certain other conditions are met. In these years, the tax filer must also offset against the CADC credit claimed any child tax credit claimed. The Colorado child tax credit, in the years in which it is available, provides eligible tax filers with a credit of either $100 or $200 per child age 5 and under.

[33] Beginning in tax year 2006, eligible Iowa tax filers may, in lieu of this credit, claim a "child development credit" of 25% of the first $1,000 of "early childhood development expenses," without regard to whether these expenses are employment-related. The amount of money that the state may expend on all such credits is limited to $250,000, however, and tax filers wishing to claim the credit must apply for it before filing a tax return.

Louisiana,[34] Maine, Maryland,[35] Nebraska, New York, Ohio, Oklahoma, Rhode Island, and Vermont.[36] Although this type of provision is the simplest to calculate, its adequacy varies considerably depending on the percentage selected.[37] In the seventeen states (and eighteen provisions) with this form of credit, the top percentage ranges from a low of 20% to a high of 110%;[38] in six of these states, the top percentage is at or below 25%;[39] in three of these states the top percentage is above 25% but below 50%;[40] in six of these states, the top percentage is between 50 and 100%;[41] and in three of these states, the top percentage equals or exceeds 100%.[42] The maximum value of the credits in these seventeen states ranges from a high of $2,310 to a low of $420.[43]

- Four states provide a *tax deduction for expenses eligible for the federal credit*. These states are Idaho, Maryland (deduction), Massachusetts,[44] and

Most state provisions are linked to the federal credit.

[34] Louisiana provides this credit for child care and a separate "household expense" credit for the care of dependents who are physically or mentally incapable of self-care that is described below. (Hereinafter these credits will be referred to as Louisiana's "child care credit" or "household expense credit" when there is a need to distinguish them.)

[35] Maryland has both this credit and a deduction for child and dependent care expenses that is described below. Tax filers eligible for both provisions may claim both. (Hereinafter, these provisions will be referred to as the Maryland "credit" or Maryland "deduction" when there is a need to distinguish them.)

[36] Vermont has a CADC credit and a separate "low-income" CADC credit, both of which are calculated by taking a percentage of the federal credit. Tax filers eligible for both credits may only claim one. (Hereinafter, these credits will be referred to as the Vermont "CADC credit" and the Vermont "LICADC credit" when there is a need to distinguish them.)

[37] In eight of these states — California, Colorado, Iowa, Louisiana (child care credit), Maryland (credit), Nebraska, New York, and Ohio — the percentage or dollar value falls as the income of the tax filer rises, thereby increasing the targeting to lower-income tax filers beyond that already provided in the federal credit. *But see infra* note 65 and accompanying text.

[38] Arkansas, Kentucky, and Oklahoma provide a credit of 20% of the federal credit; New York provides lower-income families with a credit of 110% of the federal credit.

[39] These states are Arkansas, Kansas, Kentucky, Oklahoma, Rhode Island, and Vermont (CADC credit).

[40] These states are the District of Columbia, Maine, and Maryland (credit), with Maine scheduled to increase to 50% in tax year 2006.

[41] These states are California, Colorado, Delaware, Iowa, Louisiana (child care credit, except for tax year 2006, when the top percentage is 30%), and Vermont (LICADC credit).

[42] These states are Nebraska, New York, and Ohio.

[43] Arkansas, Kentucky, and Oklahoma have maximum values of $420; New York has a maximum value of $2,310.

[44] Massachusetts provides a deduction of expenses allowed for the federal credit, except that its expense limits are $4,800 for one child or a dependent and $9,600 for two or more children or dependents. In addition, tax filers must choose between this CADC deduction and a deduction of $3,600 for maintaining a household with one dependent child under age twelve or a dependent age sixty-five or over, or a disabled dependent, or $7,200 for maintaining a household with two or more such individuals, regardless of whether the family has employment-related expenses for the care of any of these individuals. Because only the Massachusetts CADC deduction is based on employment-related child and dependent care expenses, it is the one referenced in this report; moreover, families that qualify for both deductions but have employment-related expenses over the $3,600/$7,200 limitations of the other deduction will find it more advantageous to claim the CADC deduction.

Virginia. Although the value of this type of provision is also simple to calculate — multiplying eligible expenses by the applicable tax rate — state tax rates are so low that such provisions yield low benefit amounts. Top marginal tax rates in these states vary from 7.8% in Idaho to 4.75% in Maryland. The maximum value of these four state tax deductions ranges from a high of $509 in Massachusetts to a low of $285 in Maryland.[45]

- Four states provide a *tax credit whose amount is a percentage of the expenses eligible for the federal credit.* These states are Louisiana (household expense credit), North Carolina,[46] Oregon,[47] and South Carolina. This type of provision is similar in effect to provisions that are a percentage of the federal credit, except that in this instance, unless the percentage varies inversely with income, the provision will not contain any targeting to lower-income families. Louisiana, North Carolina, and Oregon vary the percentage inversely according to income.[48] The maximum value of the credits in the states with this type of provision ranges from a high of $1,800 in Oregon to a low of $420 in South Carolina.
- One state, Minnesota, provides a tax credit that is partially determined by the amount of the federal credit. Minnesota provides a credit in "an amount equal to" the federal credit for which the tax filer is eligible, up to a maximum credit amount that is lower than the maximum federal credit amount,[49] reduced by a specific dollar amount at various income intervals for tax filers with income between $20,420 and $34,070.
- One state, New Mexico, provides a *tax credit for a portion of child care expenses whose amount is not determined by the federal credit, but is affected by the amount of the federal credit claimed.* New Mexico provides a credit of 40% of child care expenses, up to $8 per day, per child, with a maximum credit of $1,200. However, the tax filer must subtract from the amount of

[45] Massachusetts, although it does not have the highest top marginal tax rate, has the maximum value because its expense limits are higher than the limits in the other three states.

[46] North Carolina limits its expenses to $2,400 for one child or dependent and $4,800 for two or more children or dependents; accordingly the increase in the expense limits in the federal credit in EGTRRA that took effect in tax year 2003 (but, unless extended, expires after tax year 2010), did not affect the value of the North Carolina credit.

[47] Oregon has both this CADC credit and a "working family child care" credit described below. Tax filers eligible for both credits may claim both. (Hereinafter, these credits will be referred to as the Oregon "CADC credit" and the Oregon "WFCC credit" when there is a need to distinguish them.)

[48] In Louisiana the top percentage is 35% of expenses; in North Carolina the top percentage is 9% of expenses for children ages seven and older, 13% for children under age seven and other dependents who are incapable of self care; in Oregon, the top percentage is 30% of expenses; in South Carolina the percentage is a flat 7%.

[49] Because of this feature, the lowest-income Minnesota tax filers did not benefit fully from the improvements to the federal credit in EGTRRA that took effect in tax year 2003 (but, unless extended, expire after tax year 2010).

the New Mexico credit the portion of the federal credit amount applied against federal tax liability to yield the amount of the New Mexico credit that may be claimed.[50]

- One state, Hawaii, provides a *tax credit for a portion of child and dependent care expenses whose amount is not determined by the federal credit.* Its credit is 15 to 25% — with lower-income tax filers receiving the higher percentages — of child and dependent care expenses, up to $2,400 for one child or dependent and $4,800 for two or more children or dependents, for a maximum credit of $1,200.
- One state, Oregon, *provides a tax credit for a portion of child care expenses that are not determined by the federal credit and are not limited in amount.* Its credit is 8 to 40% — with lower-income tax filers receiving the higher percentages — of child care expenses, with no maximum credit amount.[51]
- One state, Montana, provides a *deduction for child and dependent care expenses that are not determined by the federal credit, up to a specified amount.* Expenses are limited to $2,400 for one child or dependent, $3,600 for two children or dependents, and $4,800 for three or more children or dependents.[52] The portion of expenses that is deductible depends on the income of the tax filer, with lower-income tax filers receiving a larger portion. The maximum tax benefit under the Montana deduction is $180.

The maximum value of all thirty-one state CADC tax provisions, excluding Oregon's WFCC credit, ranges from $180 in Montana to $2,310 in New York. Appendix A provides state-by-state descriptions, including maximum credit amounts, of each state CADC provision in effect for tax year 2005.[53]

The maximum value of all state provisions ranges from $180 to $2,310.

IV. Designing State Child and Dependent Care Tax Provisions: Issues and Choices

Numerous aspects of state CADC income tax provisions determine the value of any particular provision to any particular family and to families in general. Each of these aspects represents a choice for policy makers to make as

[50] The required offset decreases the value of the New Mexico credit as the value of the federal CADC credit increases, so that the improvements to the federal credit in EGTRRA that took effect in tax year 2003 (but, unless extended, expire after tax year 2010) decreased the value of the New Mexico credit.

[51] Both this credit's high maximum percentage amount and its unlimited expenses yield the highest maximum value of any of the state provisions. For example, at expenses of $6,000, the limit in most states, Oregon's WFCC credit would yield a maximum credit of $2,400, higher than any other state provision. However, few tax filers with adjusted gross income up to 250% of poverty, the WFCC credit's income limit, may be able to spend this much on child care.

[52] It is unclear from the Montana statute whether children and adult dependents are subject to the same expense limits, but the Montana tax form and instructions indicate that they are.

[53] When applicable, the descriptions include scheduled changes in the provisions for later tax years.

they develop and implement a state CADC tax provision. This section reviews these choices, explaining the considerations that affect them and recommending the best approach to follow. A companion "report card," *Making the Grade for Care: Ranking State Child and Dependent Care Tax Provisions*, scores each state provision in effect for tax year 2005 based on the extent to which it incorporates the best policies described below.

A. Should States Enact CADC Tax Provisions?

A CADC tax provision is one of many measures policy makers can adopt to address families' child and dependent care needs. Why should policy makers choose this measure?

As discussed above, the high cost of child and dependent care makes its affordability a central concern for many families. A tax provision is a fairly straightforward way to increase the amount of money a family has to pay for care, although the provision must be generous enough to make a significant difference.[54] Furthermore, a CADC tax provision treats employment-related care as a genuine, legitimate working expense and is the most direct way to address the inequity that arises in an income tax system when families with care expenses needed to earn income are treated as families with the same income but without such expenses. Providing families with child and dependent care assistance through a tax provision may also be more feasible politically than providing that assistance directly and, unlike direct spending programs, which are typically dependent on annual appropriations from the legislature, tax benefits are entitlements for all who qualify for them.[55] Furthermore, a CADC provision assists families in the workforce, a group for whom assistance is often politically popular.

However, CADC tax provisions do have some limitations. Most importantly, they require that families incur employment-related care expenses "up front" to receive a tax benefit months later. Some families simply do not have the income to pay for such expenses at the outset, or at all, while others can

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[54] If the provision is to reach the lowest-income tax filers, it must also be refundable. *See infra* Section IV-C-2.

[55] State CADC provisions are popular with the voters and policy makers alike. The Montana electorate, for example, in a 1994 referendum, rejected the state legislature's 1993 repeal of the state's CADC deduction. In addition, when the federal CADC credit was increased in EGTRRA in 2001 (effective in tax year 2003 but, unless extended, expiring after tax year 2010), the twenty-two states whose relevant provisions are linked to the federal credit allowed their state provisions to increase as well (although three of these states — Arkansas, California and Maine — made changes in their CADC provisions that limited the increase that otherwise would have taken effect automatically because of the federal credit increases). These states are Arkansas, California, Colorado, Delaware, District of Columbia, Idaho, Iowa, Kansas, Kentucky, Louisiana (both credits), Maine, Maryland (credit and deduction), Minnesota, Nebraska, New York, Ohio, Oklahoma, Oregon (CADC credit), Rhode Island, South Carolina, Vermont (both credits), and Virginia. Two of these states — Louisiana (child care credit) and Vermont (LICADC credit) — also made other improvements in their CADC provisions in the last four years.

afford only care that costs less than needed to derive the maximum benefit from a CADC tax provision. CADC tax provisions also do not easily address issues of access to or quality of care directly, although by enabling families to pay more for care they can indirectly affect both.[56]

In short, CADC tax provisions address some of many families' employment-related care needs, but they do not address them all, and for some families they provide little help. A comprehensive solution to the problems families confront in obtaining quality care for children and dependents requires multiple strategies, including CADC tax provisions.

Best Policy: *States should enact CADC income tax provisions as one of several measures aimed at increasing the affordability, availability, and quality of child and adult dependent care.*

B. Linkage to the Federal CADC Credit

As described above, most states with CADC tax provisions link them to the federal credit. For example, the state provision may be a credit equal to a specified portion of the federal credit or federally allowed expenses, or a deduction of federally allowed expenses or a specified portion of those expenses. The provision may improve upon the federal credit in some respects, such as by making the state provision refundable,[57] or it may limit it in some respects, such as by imposing an income test for receipt of the state provision's benefits.[58] States may choose to link their credit to the federal credit to make calculation of the state credit simple. Proponents of state CADC tax provisions may also find that in practice the most generous provisions they can get enacted are based on the federal credit.

One consideration in linking a state provision to the federal credit is whether to do so in a way that makes all or most of the federal credit's features part of the state provision. In this type of linkage, both the federal credit's advantages, such as its low-income targeting, and its deficiencies, such as gradual loss of low-income targeting because of the federal credit's failure to index its sliding scale thresholds, will be incorporated into the state provision. In addition, any time Congress changes the federal credit, the state provision linked to it will be affected automatically, regardless of the intent of the state's policy

[56] In recent years, three states have included in their CADC provisions measures designed to encourage families to use higher-quality care. *See infra* Section IV-F.

[57] *See infra* Section IV-C-2.

[58] *See infra* Section IV-C-3.

makers. Thus, when improvements are made in the federal credit, the value of the linked state provision will automatically increase. This occurred in 1981 (effective for tax year 1982) when the expense limits and credit percentages were increased and the credit's benefits were newly targeted to low-income tax filers through the addition of the sliding scale;[59] it occurred again in 2001 (effective for tax year 2003 but expiring after tax year 2010 unless extended) in EGTRRA when the sliding scale's low-income targeting was improved and the expense limits and credit percentages were again increased.[60] Similarly, when the federal credit is scaled back, the value of the linked state provision will automatically decrease.[61] This occurred in 1988 (effective for tax year 1989) when Congress lowered the age limit for children whose care expenses are covered from fifteen to thirteen.[62] Two ways to avoid these effects are to write the federal credit's provisions directly into the state code, or to reference the federal credit as of a particular date.[63] But doing so then undercuts the main reason for linking the state provision to most or all of the federal credit's features — simplifying the state calculation.

The federal credit's nonrefundability warrants special attention here. When a state CADC credit is calculated as a percentage of the federal credit — as is the case in seventeen of the twenty-seven states with CADC tax provisions — an issue arises regarding calculation of the state credit for families who received only part or none of the federal credit because the federal credit exceeded their federal income tax liability. Is the state credit based on the amount of the federal credit actually received, or is it based on the amount the family could have received before the federal credit's nonrefundability provision limited the credit actually received? For example, if a family's federal credit is $800 but its federal tax liability is only $200, the family is able to claim a credit of only $200 on its federal return. If the family's state credit is 50% of the federal credit, is the family entitled to take 50% of $800 — for a state credit of $400? Or is it only

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[59] *See supra* note 26.

[60] *See supra* notes 17 & 19.

[61] Even improvements to the federal credit can reduce the value of a state credit that references the federal credit. New Mexico, for example, as previously described, requires a tax filer to offset against the amount of the New Mexico credit the portion of the federal credit amount applied against federal tax liability. The result is that as the value of the federal credit increases, the value of the New Mexico credit decreases.

[62] *See* Family Support Act of 1988, Pub. L. No. 100-485, §703(a), 102 Stat. 2343, 2426-27 (1988) (codified as amended at I.R.C. §21 (b)(1)(A) (2005)).

[63] Arkansas, for example, provides a nonrefundable portion of its credit that is a percentage of the federal CADC credit "in effect on January 1, 2005," and a refundable portion that is a percentage of the federal CADC credit "in effect on January 1, 1993." These specific date references mean that EGTRRA's improvements to the federal credit that took effect in tax year 2003 (but, unless extended, expire after tax year 2010) automatically resulted in improvements in the nonrefundable, but not the refundable, portion of the Arkansas credit, disadvantaging the lowest-income tax filers. The date distinctions in the Arkansas statute are not reflected in the Arkansas tax forms and instructions, however, which do not require a tax filer to recalculate the filer's federal credit amount without the EGTRRA improvements in order to claim the refundable portion of the Arkansas credit.

able to take 50% of $200 — for a state credit of $100? This issue is of particular concern to lower-income families who are most likely to have their federal credit limited by the nonrefundability provision.

In the seventeen states (and eighteen provisions) that calculate the state credit based on a percentage of the federal credit, the statutory provisions of five states — California, the District of Columbia, Nebraska (refundable portion), New York, and Ohio — clearly provide that the state credit is based on the federal credit for which the tax filer is potentially eligible, without regard to the federal nonrefundability provision. (Oregon, which calculates its CADC credit as a percentage of expenses allowable for the federal credit, and Minnesota, which calculates its CADC credit based in part on the federal credit, also make clear that their state credits are not limited by the fact that the federal CADC credit is not refundable.) In contrast, the statutory provision in one state — Kansas — is explicitly limited to a percentage of the amount of the federal credit "allowed against such [tax filer's] federal income tax liability" — that is, the amount of credit actually received. In the twelve remaining states with credits based on a percentage of the federal credit, the statutory provision is ambiguous, referring to a percentage of the "allowable," "allowed," "provided," "claimed," or "eligible" federal credit.[64] However, in most of these states, the instructions or forms — or both — make clear whether the unused portion of the federal credit is part of the base figure used to determine the state credit.[65]

It is very important that state credits that are calculated as a percentage or portion of the federal credit explicitly provide that they are to be calculated without regard to the limits imposed on the federal credit amount actually received because the federal credit is not refundable. Otherwise, lower-income families will also see their state credit reduced.

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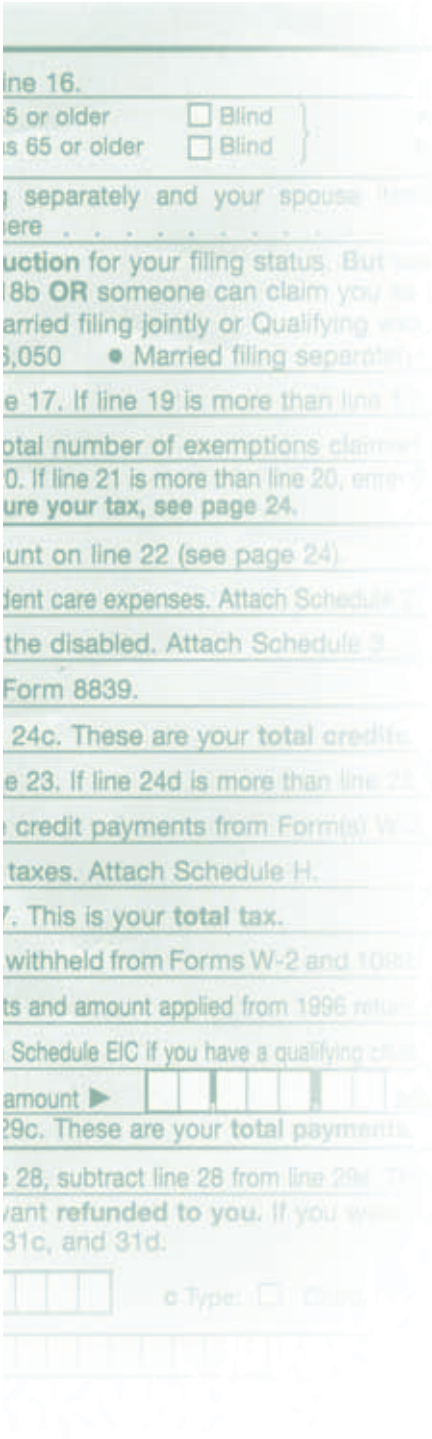
[64] These states are Arkansas, Colorado, Delaware, Iowa, Kentucky, Louisiana (child care credit), Maine, Maryland (credit), Nebraska (nonrefundable portion), Oklahoma, Rhode Island, and Vermont (both credits). The statute authorizing the Louisiana child care credit expressly provides that, beginning in tax year 2006, the credit is calculated based on the federal credit for which the tax filer is potentially eligible, without regard to the federal credit's nonrefundability provision, but only for filers with federal AGI of $25,000 or less. For tax year 2005, however, the Louisiana tax forms instruct tax filers at all income levels to use the amount of the federal credit after it has been reduced by federal tax liability in calculating the state child care credit.

[65] Only in Arkansas (nonrefundable portion) and Maryland (credit) are the forms and instructions unclear. In Kentucky the forms and instructions, and in Iowa the instructions, direct the tax filer to use the amount of the credit on line 9 of federal form 2441 or Schedule 2 of federal form 1040A to calculate the state credit; this is the amount of the federal credit before it is limited by federal tax liability. In Oklahoma the instructions direct the tax filer to apply the state percentage to the amount of the federal credit actually received. In the remaining states, the instructions either direct the tax filer to use the amount of the credit on line 48 of federal form 1040 or line 29 of federal form 1040A (Colorado, Louisiana (child care credit), Maine, Nebraska (nonrefundable portion), Rhode Island, and Vermont (both credits)) or to use the amount on line 11 of federal form 2441 or Schedule 2 to calculate the state CADC credit (Arkansas (refundable portion), Delaware). In either case, the amount on these lines, properly calculated, is the amount of the credit actually received after it is limited by federal tax liability. Of course, if a state offsets against the amount of the state credit the amount of the filer's federal credit, or otherwise uses the federal credit to reduce the state provision, it is advantageous to the filer if the state offsets the amount of the federal credit after it is limited by federal tax liability, as New Mexico does.



Best Policy: *Careful consideration should be given to whether state CADC tax provisions should be independent of the federal CADC credit or linked to it, and a decision made based on whether it seems likely that state policy makers will take a more or less generous approach now and in the future than the federal government. If a state CADC tax provision is linked to the federal credit, the state provision and the tax forms and instructions should clearly provide that it is based on the amount of the federal credit for which the tax filer is eligible regardless of whether the tax filer's total federal tax liability permits the tax filer to receive any or all of the federal credit.*

C. Targeting Assistance to Lower-Income Families

Like any other tax credit or deduction, a CADC income tax provision represents tax revenue foregone by the state. Consequently, a state is unlikely to cover all the employment-related care expenses of all families who have them. Instead, the state will divide a more limited pot of money for the CADC provision among the families with such expenses. The question is how to do that most equitably and efficiently. The more tax assistance that goes to higher-income families, the less that is available to lower-income families. But it is lower-income families who are most in need of assistance with employment-related care expenses, which can eat up a very large portion of an already limited family budget.

Best Policy: *State CADC tax provisions should target assistance to low- and moderate-income families.*

There are a number of ways to target CADC tax provisions to lower-income families.

1. Credits versus Deductions

Of the twenty-seven states with CADC tax provisions, twenty-two have credits, four have deductions, and one has both a credit and a deduction.[66] The choice between a credit or a deduction can have a large effect on the usefulness of a tax provision for lower-income families. The tax savings value of a deduction is determined by, and rises with, the marginal tax rate. This means that in a progressive income tax system, higher-income tax filers get more benefit from an identical deduction than do lower-income tax filers. For instance, the value of a deduction of $3,000 of expenses for tax filers in a 5% tax bracket is $150,

[66] The states with credits are Arkansas, California, Colorado, Delaware, the District of Columbia, Hawaii, Iowa, Kansas, Kentucky, Louisiana (two credits), Maine, Minnesota, Nebraska, New Mexico, New York, North Carolina, Ohio, Oklahoma, Oregon (two credits), Rhode Island, South Carolina, and Vermont (two credits). The states with deductions are Idaho, Massachusetts, Montana, and Virginia. Maryland has both a credit and a deduction.

while for those in a 10% bracket it is $300.[67] By contrast, an identical credit produces the same dollar value for lower- and higher-income tax filers. For instance, a credit of 25% of CADC expenses for a family with $3,000 of expenses produces a credit of $750, regardless of the family's income. Furthermore, such a credit represents a greater portion of tax liability for the lower-income family. Thus, a $750 credit is 75% of the tax liability of a lower-income family that owes $1,000 in taxes but only 15% of the tax liability of a higher-income family that owes $5,000 in taxes.

In addition, state CADC deductions tend to produce smaller tax benefits than do credits, because state tax rates tend to be relatively low. As a result, on average, CADC tax deductions provide less assistance with care expenses than do CADC tax credits. Of course, that is not always the case. The value of a deduction in a state with relatively high tax rates can be greater than the value of a credit in a state that covers only a small portion of CADC expenses.[68]

Best Policy: *State CADC tax provisions should be tax credits rather than tax deductions, as the simplest way to target CADC assistance to low-income families and to enhance the levels of assistance generally.*

2. Refundability

Refundability is critical to ensuring that a CADC tax credit provides as much assistance as possible to low-income families.[69] The lowest-income families are likely to have so little state tax liability that without a refundable CADC credit, they will derive little or no actual benefit from a CADC tax provision. Without refundability, a state CADC tax credit that looks generous on paper may in fact provide relatively little assistance to many families.

The CADC credits of thirteen states are refundable. In nine of these states — California, Colorado, Hawaii, Iowa, Minnesota, New Mexico, New York, Oregon (WFCC credit), and Vermont (LICADC credit) — the credits are fully refundable.[70] In four states — Arkansas, Louisiana (child care credit), Maine, and Nebraska — the credits are partially refundable. In Arkansas, the credit is refundable only for expenses for children under age six in "an appro-

[67] One state — Montana — has offset this effect in part by providing a larger deduction of expenses for lower-income tax filers. Nonetheless, the Montana deduction provides the lowest maximum tax benefits of any CADC provision in the nation, for families at all income levels.

[68] For instance, Idaho's top tax rate yields a maximum CADC deduction of $468 — which is greater than the maximum tax benefit provided by the CADC credits of Arkansas, Kentucky, Oklahoma, and South Carolina.

[69] Refundability is not possible for tax deductions, another reason that deductions are less effective than credits for low-income families.

[70] New York's credit is refundable only for residents.

priate early childhood program." In Maine, the credit is refundable up to $500. In Louisiana, the child care credit is refundable for tax filers with federal adjusted gross income of $25,000 or less and in Nebraska, the credit is refundable for tax filers with federal adjusted gross income of $29,000 or less. In two states with either partially refundable or nonrefundable credits —Louisiana (both credits) and Oregon (CADC credit) — tax filers with a credit amount that cannot be used fully, because the amount exceeds tax liability in a particular year, may carry forward the unused portion of the credit to the next tax year.[71]

Best Policy: *State CADC tax provisions should be fully refundable.*

3. Sliding Scales and Income Limits

States can further target CADC benefits to low-income tax filers through the use of sliding scales for determining the amount of benefits provided.

A sliding scale will produce a larger tax benefit for lower-income tax filers than for higher-income tax filers. For example, for CADC credits that are not tied to the federal credit, a sliding scale can reduce the proportion of employment-related care expenses that is claimed as the tax filer's income rises. For CADC credits that are a percentage of the federal credit, a sliding scale can reduce the proportion of the federal credit that is claimed as the tax filer's income rises, thereby providing additional targeting to that provided in the federal credit itself. Establishing a sliding scale requires decisions about the percentages that may be claimed for tax filers at different income levels and the income levels at which these different percentages apply.

Keeping the percentage as high as possible for the lowest-income tax filers ensures that they will receive meaningful assistance in meeting their CADC expenses.[72] This is especially important if a provision is calculated as a percentage of the federal credit, which itself reimburses only a maximum of 35% of CADC expenses. Thus, a state credit tied to the federal credit that provides the lowest-income tax filers with 100% of their federal CADC credit at best offsets only 35% of CADC expenses.[73] Keeping the percentage high is essential if the provision is a deduction, whose value is determined by state marginal tax rates, which tend to be low. Thus a state deduction of 100% of the tax filer's CADC

[71] In Oregon, the CADC credit may be carried forward for up to five years. In Louisiana, the household expense credit may be carried forward, but only to the next succeeding tax year; the nonrefundable portion of the child care credit may be carried forward for up to five years. In Iowa, which has a refundable CADC credit, a tax filer must choose between a refund and carrying the credit forward to the next tax year.

[72] As previously discussed, it is equally important for these tax filers that the CADC provision be refundable.

[73] As previously discussed, because the thresholds for claiming the federal credit's percentages are not indexed for inflation, and the federal credit is not refundable, very few tax filers can take advantage of the federal credit's maximum percentages of 35% of their expenses.

expenses, in a state with a marginal tax rate of only 5% for its lowest-income tax filers, at best offsets only 5% of CADC expenses.

Keeping as high as possible the threshold at which lower-income tax filers receive the highest percentage of their CADC expenses ensures that a large portion of low-income families benefit from the highest percentage. Two states, for example, set this bottom threshold at or above $40,000.[74] At a minimum, the bottom threshold should be set above the income level at which most tax filers with children and other dependents begin to pay state income taxes or, as under the federal credit, few tax filers will be eligible for the provision's maximum percentage and maximum benefit.

All seventeen states whose credits are a percentage of the federal credit indirectly incorporate the federal credit's sliding scale; of these, eight — California, Colorado, Iowa, Louisiana (child care credit), Maryland, Nebraska, New York, and Ohio — further target their credits by providing lower-income tax filers with a credit of a greater proportion of the federal credit than higher-income tax filers. Three of these states — Nebraska, New York, and Ohio — provide the lowest-income tax filers with a credit of at least 100 percent of the federal credit.[75]

Of the four states whose credit is a percentage of federal expenses, three — Louisiana (household expense credit), North Carolina, and Oregon (CADC credit) — use a sliding scale to determine the percentage of expenses that can be claimed, as does Minnesota in its credit. Of the four states whose relevant provisions are independent of the federal credit, three — Hawaii's credit, Montana's deduction, and Oregon's WFCC credit — use a sliding scale. New Mexico, by offsetting the amount of the tax filer's federal credit amount against the filer's state credit amount, effectively has a "reverse sliding scale." Since the filer's federal credit amount is higher for lower-income than higher-income families, the New Mexico credit is reduced more for lower-income than higher-income families.

Some states phase out their CADC tax provisions, making them unavailable to tax filers whose income is above a certain level. The provisions of ten states have such income limits, which range from a low of $21,424 in New Mexico to

[74] These states are California and Maryland (credit). (For households of five or more persons, Oregon's WFCC credit also has a bottom threshold at or above $40,000, since it is set at 200% of the federal poverty level.) These states have the highest bottom thresholds of the states that use a sliding scale to provide lower-income families with a higher percentage of their CADC expenses than higher-income families. One state—Colorado—has a sliding scale with a relatively low bottom threshold ($25,000), but in some years, when certain conditions are met, effectively has a threshold above $40,000 by providing all tax filers with a credit of the same amount: either a 50% credit for tax filers with federal AGI below $60,000 or a 70% credit for tax filers with federal AGI below $64,000.

[75] Nebraska's and New York's credits are also refundable.

a high of $100,000 in California.[76] The states that have provided greater amounts of assistance to lower-income families have tended to impose income limits, presumably to conserve resources that would otherwise be spent on higher-income families.[77] Of the seven states whose maximum CADC tax benefits are greater than $1,400,[78] four have income limits.[79] And of the thirteen states with refundable credits,[80] seven have income limits.[81] However, an income limit runs counter to the principle that employment-related care expenses are a genuine, legitimate work expense for all families and undermines the ability of the CADC tax provision to promote equity for women and tax equity between families with and without employment-related care expenses. Presumably in recognition of these considerations, most states with CADC provisions do not have an income limit.[82] In addition, an upper limit set too low denies assistance to families for whom employment-related care expenses use up a significant portion of family income.

Best Policy: *State CADC provisions should use sliding scales with the highest possible percentage reimbursements for the lowest-income families to target a greater amount of benefit to lower-income families. However, if possible, middle- and even higher-income families with employment-related care expenses should be eligible for some tax benefit. Income limits should not be so stringent that they do not assist families for whom employment-related care expenses are a significant burden.*

[76] The states with income limits are California, Colorado, Iowa, Maryland (credit), Minnesota, Montana, New Mexico, Ohio, Oregon (both credits), and Vermont (LICADC credit). The income limit in three of the ten states (California, Colorado, and Maryland) is $50,000 or higher; the income limit in the remaining seven states is $45,000 or less, except that the Oregon WFCC credit limit, set at 250% of the federal poverty level, ranges from $23,950 for a one-person household to $81,000 for an eight-person household.

[77] Only three states that target assistance to lower-income families through their own sliding scale do not have income limits — Hawaii, New York, and North Carolina.

[78] These states are Iowa, Louisiana (household expense credit), Minnesota, Nebraska, New York, Ohio, and Oregon (both credits). All of these states provide greater assistance to lower-income than higher-income families. Although Colorado's maximum tax benefit for tax year 2005 is $1,050, in some years it is as high as $1,470. In these years, as previously described, its maximum tax benefits are not targeted to provide greater assistance to lower-income than higher-income families; they are available to all tax filers with federal AGI below its income limits, not just tax filers with federal AGI below $25,000.

[79] These states are Iowa, Minnesota, Ohio, and Oregon (both credits).

[80] These states are Arkansas, California, Colorado, Hawaii, Iowa, Louisiana (child care credit), Maine, Minnesota, Nebraska, New Mexico, New York, Oregon (WFCC credit), and Vermont (LICADC credit).

[81] These states are California, Colorado, Iowa, Minnesota, New Mexico, Oregon (WFCC credit), and Vermont (LICADC credit).

[82] These states are Arkansas, Delaware, District of Columbia, Hawaii, Idaho, Kansas, Kentucky, Louisiana, Maine, Massachusetts, Nebraska, New York, North Carolina, Oklahoma, Rhode Island, South Carolina, and Virginia. Maryland has a limit for its credit but not its deduction; Vermont has a limit for its LICADC credit but not its CADC credit.

D. Coverage for Both Children and Adults

Although child care expenses are probably the most common employment-related care expenses, many families incur employment-related care expenses for adults — for instance, disabled adult children, spouses, or parents — that can be as great if not greater than those for children. Of the twenty-four states that calculate their CADC state credit or deduction based on the federal CADC credit, twenty-one incorporate its coverage for care-related expenses for spouses and dependents who are incapable of self-care as well as children.[83] Of the remaining three states, one — Louisiana — provides separate credits and credit amounts for child care and adult dependent care expenses;[84] one — Colorado — expressly limits its credit to child care expenses; and one — Oklahoma[85] — is ambiguous. Of the four states whose relevant provisions are independent of the federal provision, two — New Mexico and Oregon (WFCC credit) — limit coverage to care expenses for children; the other two — Hawaii and Montana[86] — like the federal provision, cover care expenses for spouses and adult dependents as well.

In three states that in their statutes expressly cover expenses for both children and adult dependents, the tax forms, the instructions, or both refer to the provision as a "child care" credit.[87] This label could mislead tax filers with expenses for employment-related care of adults, who may assume that the

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[83] These states are Arkansas (nonrefundable portion), California, Delaware, District of Columbia, Idaho, Iowa, Kansas, Kentucky, Maine, Maryland (credit and deduction), Massachusetts, Minnesota, Nebraska, New York, North Carolina, Ohio, Oregon (CADC credit), Rhode Island, South Carolina, Vermont (both credits), and Virginia. Arkansas limits the refundable portion of its credit to expenses for care for children under age six. North Carolina, in recognition of the higher cost of care for adult dependents and younger children, provides higher benefits for children under age seven and all dependents who are incapable of self-care than it does for children age seven and over.

[84] The maximum Louisiana credit for child care is $1,050; for dependent care it is $2,100.

[85] The Oklahoma statute refers to a "credit" of 20% of "the [federal] credit for child care expenses." Oklahoma's tax form and similar language in the instructions direct the tax filer to take a percentage of the "federal child care credit" but do not indicate how or whether any portion of that credit attributable to expenses incurred for adult dependent care must be excluded.

[86] The Montana statute is unclear whether its coverage of expenses for adult dependents is limited to expenses that are incurred for care in the tax filer's home. However, the Montana tax form and instructions indicate that both in-home and out-of-home care are covered for both children and adult dependents.

[87] These states are Arkansas, Delaware, and Maine. In Arkansas and Maine, part—but not all—of the state provision covers only expenses for child care. *See infra* Section IV-F. In Nebraska, the instructions, but not the tax forms, refer to the refundable portion of the Nebraska credit as the "refundable child care expenses credit."

provision covers only child care expenses and skip over it. To avoid confusion in this regard, tax forms and instructions should state clearly that adult and child care expenses are covered.[88]

All state CADC tax provisions, like the federal credit, cover child care expenses for children under a particular age. The federal age limit of thirteen applies in all but one of the states with CADC tax provisions linked to the federal credit.[89] Of the four states whose relevant provisions are independent of the federal credit, two cover expenses for children under age thirteen; the other two cover expenses for children under age fifteen.[90] Provisions that cover dependents who are incapable of self-care also apply to children above the age limit with this level of incapacity.[91]

Best Policy: *State CADC tax provisions should cover care for children, spouses and adult dependents, and tax forms and instructions should be clear about the coverage of both children and adults.*

E. Expense Limits

Only Oregon's WFCC credit does not place an absolute dollar limit on the amount of expenses a tax filer may claim. All other state CADC tax provisions, like the federal CADC credit, limit the amount of expenses. This reduces the cost of the provision to the state and in a sense is another way of targeting

[88] A corollary problem is that in two of the three states in which the CADC provisions only cover child care expenses, but the credit amounts are calculated by reference to the federal credit, the authorizing statutes and tax forms and instructions do not make clear whether the state provision is calculated based on a federal credit that only includes child care expenses or a federal credit that also includes adult dependent care expenses. In Louisiana, the statute describes the credit as a "credit…for child care expenses for which a resident individual claims a child care tax credit on his federal tax return. The credit shall be calculated using…percentages of the credit for child care expenses claimed on the …individual's tax return." (The statute was amended, effective for tax years beginning on or after January 1, 2006, but the new version, with respect to this issue, is equally unclear. It describes the child care credit as a "credit…for child care expenses for which a resident individual is eligible pursuant to the federal income tax credit provided by Internal Revenue Code Section 21….") The instructions to the 2005 tax form direct the filer simply to enter "[f]rom Federal Form 1040, line 48, or from Federal Form 1040A, line 29…the amount of the Federal Child Care Credit claimed." In both cases the reference is to a federal credit amount that may include adult dependent care expenses. (For a description of Louisiana's household expense credit, which similarly does not make clear whether it is calculated based on a federal credit that includes adult dependent care expenses, *see infra* note 109.) In New Mexico, the statute directs the tax filer to offset against the state credit the amount of "the federal credit for child and dependent care expenses the tax [filer] is able to deduct from federal tax liability." The instructions and similar language in the tax form direct the filer to "enter the amount of the federal child care credit…claimed." In both cases it is unclear whether only the portion of the federal credit claimed for child care expenses, or a portion that may include adult dependent care expenses, must be offset against the New Mexico child care credit.

[89] As previously described, Arkansas' credit is refundable only for care expenses for children under age six.

[90] Hawaii and Oregon (WFCC credit) cover expenses for children under age thirteen; New Mexico and Montana cover expenses for children under age fifteen.

[91] Oregon's WFCC credit, which only covers children, covers disabled children under its own definition of disability, which in some instances requires a child to be under age nineteen.

assistance to lower-income families, since only families with higher incomes can afford to incur relatively higher care expenses.[92]

However, it is very important that expense limits be realistic in terms of the cost of care. Otherwise, families may receive no assistance for many of their expenses, which undercuts the effectiveness of the tax provision in providing meaningful assistance and reducing tax inequity between families with CADC expenses and families without such expenses.[93] Even picking a limit that corresponds to the average cost of care in the state may be too low, because that leaves many tax filers who have employment-related care expenses with uncovered expenses. Furthermore, an expense limit that is too low may push families in the direction of lower-quality care.

States whose CADC provisions are linked to the federal credit generally incorporate its expense limits of $3,000 for one child or dependent and $6,000 for two or more such individuals,[94] less than the average cost of care.[95] The states whose relevant provisions are independent of the federal credit, except Oregon's WFCC credit, are not better in this regard; Hawaii limits expenses to $2,400 for one child or dependent and $4,800 for two or more children or dependents; Montana limits expenses to $2,400 for one child or dependent,

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[92] Indeed, it may be more important for low-income families that the percentage of expenses that may be claimed is high than that the expense limits are high. *See supra* Section IV-C-3.

[93] This is especially true if the provision offsets only a low percentage of such expenses.

[94] As previously described, EGTRAA increased the federal expense limits to $3,000 for one child or dependent and $6,000 for two or more children or dependents, beginning in tax year 2003 (but, unless extended, expiring after tax year 2010), thereby automatically increasing the expense limits in most states linked to the federal credit. However, the expense limits of three states linked to the federal credit were not affected by this increase because they are expressly not the same as the federal limits. The expense limits for Massachusetts' deduction were not affected because they are higher than the federal credit expense limits — $4,800 for one child or dependent and $9,600 for two or more children or dependents, and the expense limits for North Carolina's credit were not affected because they are lower than the federal expense limits — $2,400 for one child or dependent and $4,800 for two or more children or dependents. The expense limits for the portion of the Arkansas credit that is refundable were also not affected, because they are linked to the federal credit in effect on January 1, 1993, when the limits were $2,400 for one child or dependent and $4,800 for two or more children or dependents, although, as previously described, the Arkansas tax forms and instructions treat the expense limits for the refundable portion of the credit, which only covers child care expenses, as if they were the same as the limits for the nonrefundable portion—$3,000 for one child and $6,000 for two or more children.

[95] *See* Breaking the Piggy Bank *supra* note 4. Minnesota permits some tax filers to claim its CADC credit based on "deemed" expenses. Licensed family child care home operators may claim the CADC credit for their own children, cared for in their family child care home, even if they have not incurred actual employment-related expenses for that care. The child must be under age six; if the child is sixteen months of age or younger, the amount of expenses deemed to have been paid is $3,000, and if the child is older than sixteen months of age but under age six, the amount of expenses deemed to have been paid is the amount the licensee would charge for the care of a child of the same age for the same number of hours. In addition, married couples may claim the Minnesota CADC credit based on deemed expenses of the lesser of $3,000 or the couple's combined earned income for a child under age one at the end of the tax year, even if the couple has not incurred actual employment-related expenses for that child.

$3,600 for two children or dependents, and $4,800 for three or more children or dependents, reduced by one-half of the tax filer's adjusted gross income over $18,000;[96] and New Mexico limits expenses to $8.00 per day, per child.[97]

Best Policy: *Expense limits in state CADC tax provisions should at least reflect the average costs of good-quality care in the state.*

F. Quality of Care Requirements

Families have different preferences in regard to the care arrangements that meet their employment-related needs, but presumably all would like the care to be of high quality. As previously described, the federal credit imposes some minimum quality standards by requiring that expenses paid to a dependent care center are covered only if the center meets applicable state and local laws.[98] This requirement is incorporated into the provisions of most of the states that link their CADC provisions to the federal credit.[99] Of the states with independent CADC provisions, only Hawaii has a similar limitation.

Three states whose provisions are linked to the federal CADC credit have done more to encourage higher-quality care, although two of these states have limited their quality enhancements to child care.

Arkansas provides that its credit is refundable for care for children under age six in an "appropriate early childhood program," which is defined as a "developmentally appropriate program for young children, approved by the Department of Education," and complying with regulatory guidelines of the Department of Health and Human Services and the Department of Education. The Arkansas approach, because of its age limitation, affects only a portion of children — and no adult dependents — receiving employment-related care. It also does not help families meet the higher cost of higher-quality care by providing them with a higher credit amount; indeed, as previously described, because the refundable portion of the Arkansas credit is linked to the federal CADC credit in effect in 1993, the changes in EGTRRA did not increase its value as they

[96] Montana, similar to Minnesota, permits licensed and registered operators of family child care or group child care homes to claim its CADC deduction for their own children cared for with "at least one unrelated child in the ordinary course of business," based on deemed expenses. The deemed amount is the amount the operator charges for the care of a child of the same age for the same number of hours, subject to the expense limits of Montana's deduction.

[97] Some states, whether they are linked to the federal credit or not, impose additional restrictions on expenses. For example, California, New Mexico, and Vermont (LICADC credit) require that the expenses be incurred in their respective states.

[98] The effectiveness of this provision depends on the adequacy of the laws and regulations of each state and local area.

[99] Vermont's LICADC credit has its own quality standards, described below.

did the value of nonrefundable portion of the Arkansas credit. Accordingly, the maximum value of the refundable portion is *lower* — $288 — than the maximum value of the nonrefundable portion — $420.[100]

Maine, in contrast, permits a doubling of its partially refundable credit (from 21.5% to 43% of the federal CADC credit[101]) for expenses for "quality child care services," which are defined as services for care provided at a child care site that meets minimum licensing standards; is accredited by an independent, nationally recognized program approved by the Maine Department of Human Services, Office of Head Start and Child Care; utilizes recognized quality care indicators for child care services approved by the Maine Department of Human Services, Office of Head Start and Child Care; and includes provisions for parent and client input, a review of the provider's policies and procedures, a review of the provider's program records, and an on-site program review. Although Maine's provision is broader in its application and clearer in its quality requirements than Arkansas' provision, it, too, only covers child care.[102]

Vermont, like Arkansas, targets its provision to encourage high-quality care to lower-income tax filers but, like Maine, does so by providing filers who use such care with a higher credit amount. Filers eligible for Vermont's LICADC credit receive a refundable credit calculated at 50% of the federal credit, more than double Vermont's CADC credit of 24% of the federal credit. Moreover, Vermont's LICADC credit, unlike Arkansas' and Maine's quality-enhancing credits, covers care expenses for both children and adult dependents. The expenses must be for care provided in a "registered home or licensed facility certified by the agency of human services as meeting national accreditation or national credential standards endorsed by the agency," and the tax filer must have federal adjusted gross income below $30,000, if single, or $40,000, if married. Tax filers who are eligible for both Vermont's LICADC credit and

[100] Although this distinction is clear in the statute, as previously described, the Arkansas tax forms and instructions allow a maximum credit amount of $420 for both the refundable and nonrefundable portions of the state credit. A tax filer must use only the portion of the filer's federal credit amount claimed that is attributable to child care expenses that qualify for the refundable portion of the Arkansas credit in calculating the refundable portion of the state credit, but this is the only limitation on the use of the filer's federal credit amount in calculating the state credit.

[101] These percentages are scheduled to increase from 21.5% to 25% and from 43% to 50% in tax year 2006.

[102] The Maine tax forms and instructions make clear that the tax filer must use only the portion of the tax filer's federal credit amount that is attributable to child care expenses that qualify for the Maine "quality child care" credit in calculating the higher state credit amount for quality child care services.

Vermont's CADC credit must chose between the two credits but will find it more advantageous to claim the LICADC credit, both because it is refundable and because of its higher credit amounts.[103]

Best Policy: *State CADC tax provisions should encourage both child and dependent care that is of high quality by offsetting a greater portion of the cost of such care.*

G. Indexing for Inflation

Some state CADC tax provisions include absolute dollar amounts for expense limits, sliding scale thresholds, and income limitations or maximum credit amounts. As discussed above in terms of the federal credit, failure to adjust these amounts to account for inflation erodes a provision's ability to provide adequate amounts of assistance to families with employment-related care expenses and to target greater benefits to the most needy families.

State provisions that are tied to the federal CADC credit are likely to have that credit's lack of indexing incorporated into their provisions. If a state adds additional sliding scales or income limitations, however, these provisions can be indexed. Only two state provisions include indexing requirements. Oregon's WFCC credit varies the percentage of expenses that may be claimed based on a household's federal poverty level, which is itself adjusted annually for inflation.[104] Minnesota adjusts its credit's income limitation annually for inflation.[105]

Best Policy: *Expense limits, sliding scale thresholds, income limits, and other similar numerical amounts in state CADC provisions should be indexed for inflation.*

H. Forms

Many states in their tax forms and instructions highlight the availability of the CADC tax provision, making it easier for tax filers to claim the credit or deduction for which they qualify. Twenty-three states provide a separate line

[103] Both the authorizing statute for Vermont's LICADC credit and the tax forms and instructions make clear that the tax filer must use only the portion of the tax filer's federal credit amount that is attributable to care expenses that qualify for the Vermont LICADC credit in calculating the LICADC credit.

[104] Oregon also indexes the earned income floor that determines eligibility for its WFCC credit, but in this instance indexing makes it harder for low-income families to claim the credit, since each year they must earn more to be eligible for its benefits.

[105] Although Colorado's credit is not indexed for inflation, in some years in which state revenues increase above a specified amount, the amount of the credit increases for at least some tax filers.

on the tax form for the CADC provision, alerting even tax filers who do not carefully read the instructions to its availability.[106] In contrast, the forms of seven states have a line for "credits" or "deductions" and refer the tax filer to a separate schedule on which credits or deductions may be claimed, without mentioning until the instructions that the CADC provision is among these credits or deductions.[107] This is problematic, especially for lower-income tax filers who often do not qualify for many credits or deductions and thus may not know to look in this section of the instructions to learn of their eligibility for the CADC provision.[108] Although it may seem unrealistic to expect a state with many credits or deductions to single out its CADC provision for special attention, the vast majority of states have done so, presumably in recognition of the fact that a large number of tax filers are eligible for the provision.[109]

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[106] These states are Arkansas, California, Colorado, Delaware, District of Columbia, Hawaii, Iowa, Kansas, Kentucky, Louisiana (child care credit), Maine, Maryland (deduction), Massachusetts, Minnesota, Nebraska, New York, Ohio, Oklahoma, Oregon (both credits), Rhode Island, South Carolina, Vermont (LICADC credit), and Virginia. Maryland, however, highlights the CADC deduction only on its resident tax form, not its nonresident form.

[107] These states are Idaho, Louisiana (household expense credit), Maryland (credit), Montana, New Mexico North Carolina, and Vermont (CADC credit). In Montana, unlike the other states with deductions, only tax filers that itemize their deductions, rather than claim the standard deduction, may claim the CADC deduction, yet neither the forms nor the instructions highlight this requirement.

[108] This is especially problematic when a state has more than one CADC provision but provides a separate line on the tax form for only one of its provisions, as Louisiana does for its child care but not its household expense credit, Maryland does for its deduction but not its credit, and Vermont does for its WFCC but not its CADC credit.

[109] An example of how a state's forms and instructions may mitigate against tax filers' claiming their CADC benefits is the treatment of Louisiana's household expense credit. The Louisiana form does not mention the credit. Instead it simply has a line for "other nonrefundable tax credits." The instructions state that among the 34 nonrefundable credits that a taxpayer may claim is the credit for "household expense." The limited instructions state that the household expense credit may be claimed by a "person who maintains a household, which includes one or more dependents who are physically or mentally incapable of caring for themselves," and adds that the credit is "equal to the applicable percentage of employment-related expenses allowable pursuant to Section 21 of the Internal Revenue Code," but does not explain "Section 21 of the Internal Revenue Code" to the tax filer or provide any further information on how to determine the tax filer's eligibility for, or the amount of, the credit. (The Section 21 citation is to the federal CADC credit.) Instead, the tax filer is directed to "contact the Department [of Revenue] for information on qualifying for this credit." A search of the Department of Revenue's web site revealed a one-page description of the credit. In some respects, this description is equally oblique. It provides that "expenses allowed for the credit are for household services and care of a qualifying individual if they are incurred to enable the tax filer to be gainfully employed (26 U.S.C.A. §21)." A qualifying individual is described as a dependent "physically or mentally disabled," but the reference to 26 U.S.C.A. §21 (the federal CADC credit) is not explained. In other respects, the one-page description is more detailed but quite technical. Thus the only explanation of how to calculate the amount of the credit states: "The credit is 35 percent of employment-related expenses. The credit is reduced by one percentage point (but not below 20 percent) for each $2,000 or portion thereof) of a tax filer's adjusted gross income that exceeds $15,000 in a taxable year." In both respects the one-page description is not very helpful to the tax filer. Since the household expense credit is worth as much as $2,100 to the tax filer, and credit amounts not used in a particular year may be carried forward to the next

Some states, like the federal government,[110] offer a short form for tax filers with relatively uncomplicated tax situations. Short forms are used primarily by tax filers with relatively low incomes.[111] Seventeen states with CADC provisions have both long and short forms but only five of these states allow tax filers to claim the CADC credit or deduction on the short form.[112] If a state has a short form, failure to include the CADC provision on the form may result in many eligible families, particularly lower-income families, not claiming CADC tax benefits for which they qualify.

Best Policy: *States should highlight CADC tax provisions in their forms and instructions and otherwise make it easy for tax filers to understand and claim CADC provisions for which they are eligible. If a state has a short form, tax filers should be able to claim the CADC provision on that form.*

succeeding tax year (but only that year), this failure to provide the tax filer with any useful information on how to claim the credit or calculate the credit amount is particularly problematic. This is especially so when the treatment of the Louisiana household expense credit is compared to the treatment of the Louisiana child care credit on the same tax form. There are separate lines for entering the tax filer's "federal child care credit" amount (which is described as the amount that will be "used to calculate [the tax filer's] 2005 Louisiana Child Care Credit"), the "2005 refundable child care credit," and the "2005 nonrefundable child care credit." The instructions also provide a worksheet and line-by-line instructions on how to calculate the child care credit. However, the tax forms and instructions for both the Louisiana child care and the Louisiana household expense credit do not make clear whether the credits are calculated based on a federal credit that only includes child or dependent care expenses, or a federal credit that may include both types of expenses. *See supra* note 88.

[110] The federal government has a long, short and EZ tax form. Tax filers may use the long or short form to claim the federal CADC credit. However, since the EZ form may only be used by tax filers not claiming children or other dependents, it may not be used to claim the federal CADC credit.

[111] For example, in tax year 1983, the year the federal CADC credit was added to the short form 1040A, over 1.4 million additional tax filers claimed the credit. In tax year 2003, the most recent year for which data are available, nearly 1.7 million tax filers claimed the federal CADC credit on form 1040A and the average adjusted gross income for tax filers using form 1040A was $22,700, compared to $64,000 for tax filers using the long form 1040. (Calculations by the National Women's Law Center based on Internal Revenue Service data for tax years 1982, 1983 and 2003.)

[112] The five states that allow tax filers to claim the CADC provision on the short form are Arkansas, Hawaii, New York, Oregon (both credits), and South Carolina. The states that have short forms but only allow tax filers to claim the CADC provision on the long form are California, Delaware, Iowa, Maine, Maryland (credit and deduction), Montana, Ohio, and Rhode Island. The remaining four states that have short forms only permit tax filers without children or dependents to use such forms — the District of Columbia, Idaho, Kentucky, and Nebraska. All states allow tax filers to file their taxes electronically, and some states also allow tax filers to "telefile" by telephone. In the states with electronic filing, tax filers may use long or short forms, depending on the general requirements for use of these forms. In the states with telefiling, some allow tax filers to claim the CADC provision and others do not.

I. Filing Requirements for Married Couples

The federal government and most states generally require in their statutes or tax forms and instructions that a married couple file a joint return to be eligible for the CADC tax credit or deduction.[113] Nine states, however, generally allow married couples to file separate returns.[114] Most of these states (and a few of the states that generally require married couples to file a joint return) have rules for married couples filing separate returns to prevent a couple from receiving the tax benefit twice.[115] However, a few states' requirements as to how the CADC tax provision is to be split between the spouses when they file separately may unfairly reduce the total tax benefit the family receives. For instance, the tax credits of Delaware and New York require that when a couple files separately, the credit must be applied against the tax owed by the spouse with the lower income. When the credit is not refundable, as in Delaware, such a provision could result in partial or full loss of the credit, depending on the tax liability of the spouse with the smaller income. More reasonable approaches are those taken by Idaho, New Mexico, and Montana — whose provisions require the spouses to split the benefit evenly — and by Iowa, Maryland (deduction), and Kentucky[116] — whose provisions require the spouses to divide the benefit according to the ratio of their respective incomes to their combined income. The best approaches are those of the District of Columbia and Virginia, which allow spouses to divide the CADC provision in the way that maximizes their CADC tax benefit, so long as they receive the benefit only once. This approach is especially appropriate given that the federal credit and the state CADC provisions currently in effect leave many families with many uncovered expenses.

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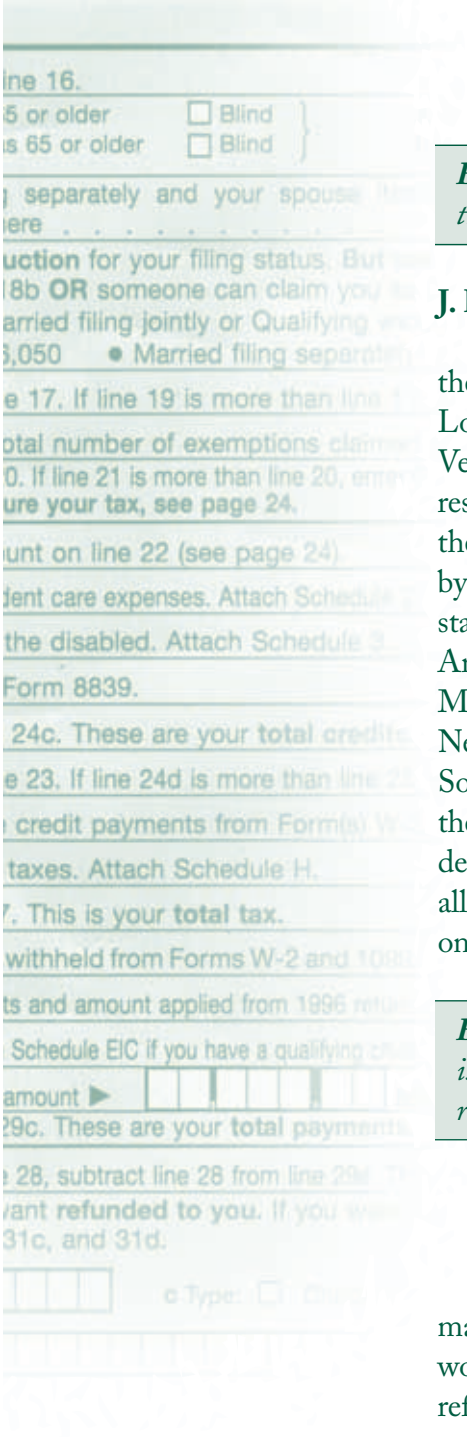
[113] These states are California, Colorado, Hawaii, Idaho, Kansas, Louisiana, Maine, Massachusetts, Minnesota, Nebraska, New York, North Carolina, Ohio, Oklahoma, Oregon (both credits), Rhode Island, South Carolina, and Vermont (both credits). Usually these states make exceptions for certain separated couples and for couples in which one spouse was a nonresident or part-year resident, allowing these couples to file separately. The Massachusetts requirement applies equally to same-sex married couples and the Vermont requirement applies equally to couples in a civil union.

[114] These states are Arkansas, Delaware, District of Columbia, Kentucky, Iowa, Maryland (credit and deduction), Montana, New Mexico, and Virginia. In the District of Columbia and Montana, married couples must either file jointly or file separately on the same form in order to claim the CADC credit or deduction.

[115] These states are Arkansas (on some forms), Delaware, District of Columbia, Kentucky, Idaho, Iowa, Maryland (deduction), Montana, New Mexico, New York, and Virginia.

[116] Kentucky explains this rule only in its nonresident form and instructions.



Best Policy: *State CADC tax provisions should permit married couples to split the credit or deduction in the way that maximizes their benefit.*

J. Residency

Eleven states limit at least one of their CADC provision to residents — the District of Columbia,[117] Colorado, Delaware, Hawaii, Kansas, Kentucky, Louisiana (child care credit), Nebraska, New Mexico, Oklahoma,[118] and Vermont (LICADC credit) — with many of these states allowing part-year residents to apportion the amount of the credit or deduction based either on the time lived in the state or the income earned in the state, or more roughly, by offsetting the taxes due in the state by taxes paid in another state. Eighteen states allow nonresidents to claim at least one of their CADC provisions — Arkansas, California,[119] Idaho, Iowa, Louisiana (household expense credit), Maine, Maryland (credit and deduction), Massachusetts, Minnesota, Montana, New York,[120] North Carolina, Ohio, Oregon (both credits), Rhode Island, South Carolina,[121] Vermont (CADC credit), and Virginia — with many of these states providing for some apportionment of the amount of the credit or deduction based on income earned in the state. A reasonable approach is to allow nonresidents to take the CADC credit or deduction, apportioned based on income earned in the state.

Best Policy: *State CADC tax provisions should provide explicitly that eligibility is not limited to residents; states may want to prorate benefits for part-year residents.*

V. Conclusion

Carefully drafted state child and dependent care tax provisions can help many families with employment-related care expenses, promote equity for women, and enhance tax equity. In general, the most effective provisions are refundable credits that target much of their assistance to lower-income families.

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[117] The District of Columbia limits its income tax to residents, thereby limiting its CADC credit also to residents.

[118] In Oklahoma, the credit is available to nonresident members of the Armed Forces.

[119] Because the California credit may only be claimed for expenses for care provided in California, and only to the extent the tax filer has California earned income, it may not be easy for nonresidents to claim the credit.

[120] New York limits nonresidents to a nonrefundable credit; only residents are eligible for a refundable credit, with the credit amount based on time of residency in the state.

[121] South Carolina allows nonresidents to claim the credit if they are residents of a state that would allow South Carolinians to take a CADC credit or deduction, although this reciprocity requirement is only described in the South Carolina instructions to the long-form, not the short-form, tax return.

VI. Appendices

Appendix A — State Child and Dependent Care Tax Provisions: Tax Year 2005

State	Basic Provision	Eligible Expenses	Refundable	Maximum: One Child/ Dependent	Maximum: Two or More Children/ Dependents
AR	A *credit* of 20% of the "allowable"[1] federal CADC credit.[2] The reference to the federal credit for the nonrefundable portion of the Arkansas credit is to the federal credit "in effect on January 1, 2005," but the reference to the federal credit for the refundable portion is to the federal credit "in effect on January 1, 1993."[3]	Expenses eligible for the federal CADC credit.	Yes, but only for care for children under age 6 in an "appropriate early childhood program."[4]	$210	$420
CA	A *credit* of a specified percentage of the "allowable"[5] federal CADC credit as follows: • 50% if federal AGI[6] is $40,000 or less • 43% if federal AGI is $40,001-$70,000 • 34% if federal AGI is $70,001-$100,000. No credit is allowed if federal AGI is over $100,000.	Expenses eligible for the federal CADC credit, except that the expenses must be incurred for care provided in California.	Yes	$525	$1,050

[1] When a state credit is calculated as a percentage of the federal credit for Child and Dependent Care (CADC) expenses – as is the case in most states with CADC tax provisions – an issue arises regarding calculation of the state credit for tax filers who received only part or none of the federal credit because the federal credit exceeds their federal income tax liability and is not refundable. Is the state credit based on the amount of federal credit actually received, or is it based on the amount the tax filer could have received if the federal credit had not been limited by the tax filer's federal tax liability? A number of state statutes clearly provide that the state credit is based on the amount of the federal credit for which the tax filer is potentially eligible, without regard to the tax filer's federal tax liability, and one state makes clear that it is based only on the amount of the credit actually received. In the remaining states with credits based on a percentage of the federal CADC credit, the statutory provision is ambiguous, referring to a percentage of the "allowable," "allowed," "provided," "claimed," or "eligible" federal credit. In most instances, the forms and/or instructions clarify this ambiguity.

[2] The federal CADC credit allows tax filers to claim a portion of their employment-related expenses for in-home and out-of-home care for:

- children under age 13,
- spouses physically or mentally incapable of self-care, and
- dependents age 13 or older and physically or mentally incapable of self-care.

The portion of expenses allowed for the federal credit decreases as the tax filer's income increases, and the credit is not refundable. The Economic Growth and Tax Reduction and Reconciliation Act (EGTRRA) increased both the dollar limits on eligible expenses to $3,000 for one child or dependent, and $6.000 for two or more children or dependents, and the percentage of eligible expenses that may be claimed as a credit for tax filers with adjusted gross income up to $43,000. The maximum federal credit is $1,050 for one child or dependent and $2,100 for two or more children or dependents. These changes took effect in tax year 2003 but, unless extended, expire after tax year 2010.

[3] Thus the improvements in the federal CADC credit in EGTRRA automatically resulted in improvements in the nonrefundable, but not the refundable, portion of the Arkansas CADC credit. The date distinctions in the Arkansas statute are not reflected in the Arkansas tax forms or instructions for tax year 2005, however, which direct tax filers eligible for the refundable portion of the state credit to calculate that portion based on "the Federal Child Care Credit" claimed, reduced only by the portion of the filer's federal credit amount that is not attributable to child care expenses that qualify for the refundable portion of the state credit.

[4] An "appropriate early childhood program" is defined as a "developmentally appropriate program for young children . . . approved by the Department of Education as complying with regulatory guidelines" of the Department of Health and Human Services and the Department of Education.

[5] The California statute specifically says that the state credit is based on the amount of the federal credit allowable, "without taking into account whether there is a federal tax liability."

[6] AGI is adjusted gross income.

Appendix A (Continued)

State	Basic Provision	Eligible Expenses	Refundable	Maximum: One Child/ Dependent	Maximum: Two or More Children/ Dependents
CO	A *credit* of a specified percentage of the federal CADC credit for "child care" expenses "claimed" as follows: • 50% if federal AGI is $25,000 or less • 30% if federal AGI is $25,001-$35,000 • 10% if federal AGI is $35,001-$60,000. No credit is allowed if federal AGI exceeds $60,000. An alternative calculation of the credit applies if, in any tax year, the amount of revenue for the state fiscal year immediately preceding the tax year exceeded the limitation on state fiscal spending imposed by the state constitution and the voters did not authorize the state to retain and spend all of the excess state revenues for that fiscal year. In such tax years, the credit is 50% of the federal credit if federal AGI is $60,000 or less, reduced by any state child credit claimed. A third calculation applies if the amount of revenue for the state fiscal year immediately preceding the tax year exceeded the limitation on state fiscal spending imposed by the state constitution by at least $360.3 million[7] and the voters did not authorize the state to retain and spend all of the excess state revenue for that fiscal year but the total amount required to be refunded pursuant to the state constitution is less than the total amount of credits. In such tax years, the credit is 70% of the federal credit if federal AGI is $64,000 or less, reduced by any state child credit claimed. No credit is allowed if federal AGI exceeds $64,000.[8]	Child care expenses eligible for the federal CADC credit.	Yes	$525	$1,050
DE	A *credit* of 50% of the "allowable" federal CADC credit.	Expenses eligible for the federal CADC credit.	No	$525	$1,050

[7] This figure is adjusted annually to reflect growth in Colorado personal income.

[8] In 2005, Colorado voters authorized the state by referendum to retain and spend all the excess state revenue for fiscal years 2005-2010. Accordingly, and assuming no changes in state or federal law in the interim, tax filers with AGI of $60,000 or less are entitled to a maximum credit of $525 for one child and $1,050 for two or more children for tax years 2005 through 2010. Colorado's maximum credit amounts may, in some years, be as high as $735 for one child and $1,470 for two or more children for tax filers with AGI of $64,000 or less.

Appendix A (Continued)

State	Basic Provision	Eligible Expenses	Refundable	Maximum: One Child/ Dependent	Maximum: Two or More Children/ Dependents
DC	A *credit* of 32% of the "allowed"[9] federal CADC credit.	Expenses eligible for the federal CADC credit.	No	$336	$672
HI	A *credit* of a specified percentage of eligible expenses as follows: • 25% if Hawaii AGI is $22,000 or less • 25%, reduced (but not below 15%) by one percentage point for every $2,000 (or fraction thereof) by which AGI exceeds $22,000 but is no more than $40,000 • 15% if Hawaii AGI exceeds $40,000.	Expenses eligible for the federal CADC credit, except that expenses are limited to $2,400 for one child or dependent and $4,800 for two or more children or dependents.[10]	Yes	$600	$1,200
ID	A *deduction*[11] of expenses eligible for the federal CADC credit.	Expenses eligible for the federal CADC credit.	No	$234	$468
IA	A *credit* of a specified percentage of the "provided" federal CADC credit as follows: • 75% if Iowa net income is less than $10,000 • 65% if Iowa net income is $10,000-$19,999 • 55% if Iowa net income is $20,000-$24,999 • 50% if Iowa net income is $25,000-$34,999 • 40% if Iowa net income is $35,000-$39,999. No credit is allowed if Iowa net income is $40,000 or more.[12]	Expenses eligible for the federal CADC credit.	Yes	$788	$1,575

[9] The District of Columbia statute specifically states that the D.C. credit is based on the amount of the federal credit allowed, "regardless of the amount of the credit actually used to offset federal tax liability."

[10] Hawaii's provision is independent of the federal credit but covers the same expenses as the federal credit, except for its dollar limitations, and for that reason its expenses are not set forth separately here.

[11] Idaho's top tax rate is 7.8%.

[12] Beginning in tax year 2006, tax filers with Iowa net income of $40,000-44,999 are eligible for a credit of 30% of the federal credit, and no credit is allowed if Iowa net income is $45,000 or more. In addition, beginning in tax year 2006, eligible tax filers with Iowa net income of less than $45,000 may claim either the CADC credit or a new, refundable "child development credit" that is not based on whether the filer has employment-related expenses. The child development credit is equal to 25% of the first $1,000 of "early childhood development expenses" for children ages 3 through 5. "Early childhood development expenses" are expenses incurred for "services provided to a dependent by a preschool…, materials, and other activities," including books, instructional materials, lesson plans and activities. The amount of money that the state may spend on child development tax credits is limited to $2,500,000 annually; tax filers intending to claim such a credit must do so in advance of filing a tax return, by application with supporting documentation, and their childhood development credit may be reduced on a pro rata basis if the limit on the total credits for that year would otherwise be exceeded.

Appendix A (Continued)

State	Basic Provision	Eligible Expenses	Refundable	Maximum: One Child/ Dependent	Maximum: Two or More Children/ Dependents
KS	A *credit* of 25% of the federal CADC credit "allowed."[13]	Expenses eligible for the federal CADC credit.	No	$263	$525
KY	A *credit* of 20% of the "allowed" federal CADC credit.	Expenses eligible for the federal CADC credit.	No	$210	$420
LA	A *credit* for child care of a specified percentage of the federal CADC credit for "child care expenses claimed"[14] by the tax filer as follows: 50% if federal AGI is $25,000 or less[15] 30% if federal AGI is $25,001-$35,000 10% if federal AGI is $35,001-$60,000, but no more than $25 if federal AGI is over $60,000;	Expenses eligible for the federal CADC credit.[16]	Yes, if federal AGI is $25,000 or less.[17]	$525	$1,050
LA	A "household expense" *credit* for care for "dependents…physically or mentally incapable of [self-care]" equal to the applicable percentage of expenses allowable for the federal CADC credit.	Expenses eligible for the federal CADC credit.[18]	No[19]	$1,050	$2,100

[13] The Kansas statute specifically says that the state credit is based on the amount of the federal credit allowed "against [the] tax filer's federal income tax liability."

[14] The Louisiana statute expressly provides that, beginning in tax year 2006, the Louisiana child care credit for tax filers with federal AGI of $25,000 or less is calculated based on the federal credit "before it is reduced by the amount of the individual's federal income tax." For tax year 2005, the Louisiana tax forms instruct individuals at all income levels to use the amount of the federal credit after it has been reduced by federal tax liability in calculating the state credit.

[15] The credit amount is 25% of the federal credit for tax year 2006 but reverts to 50% of the federal credit beginning in tax year 2007.

[16] The Louisiana tax forms and instructions for tax year 2005 do not make clear whether the tax filer should use only the portion of the federal credit claimed for child care expenses, or a portion that may include adult dependent care expenses, to calculate the state credit.

[17] For tax filers with AGI over $25,000, if the credit exceeds the income tax due, the unused amount of the credit may be carried forward as a credit against tax liability in subsequent years, for up to five years.

[18] The Louisiana tax forms and instructions for tax year 2005 do not make clear whether the tax filer should use only the portion of the federal credit claimed for dependent care expenses, or a portion that may include child care expenses, to calculate the state credit.

[19] If the credit exceeds the income tax due, the unused amount of the credit may be carried forward as a credit against tax liability for the next succeeding tax year.

Appendix A (Continued)

State	Basic Provision	Eligible Expenses	Refundable	Maximum: One Child/ Dependent	Maximum: Two or More Children/ Dependents
ME	A *credit* of 21.5%[20] of the "allowable" federal CADC credit, increasing to 43%[21] for "quality child care services."[22]	Expenses eligible for the federal CADC credit, except that only expenses for "quality child care services" are eligible for the higher credit amount.	Yes, up to $500.	$452	$903
MD	A *deduction*[23] of expenses up to the dollar amount of expenses allowed under the federal CADC credit.	Expenses eligible for the federal CADC credit.	No	$143	$285
MD	A *credit* of a specified percentage of the federal CADC credit "properly claimed" as follows: • 32.5% if federal AGI is $41,000 or less • 29.25% if federal AGI is $41,001-$42,000 • 26.0% if federal AGI is $42,001-$43,000 • 22.75% if federal AGI is $43,001-$44,000 • 19.5% if federal AGI is $44,001-$45,000 • 16.25% if federal AGI is $45,001-$46,000 • 13.0% if federal AGI is $46,001-$47,000 • 9.75% if federal AGI is $47,001-$48,000 • 6.50% if federal AGI is $48,001-$49,000 • 3.25% if federal AGI is $49,001-$50,000. No credit is allowed if federal AGI exceeds $50,000.	Expenses eligible for the federal CADC credit.	No	$341	$683

[20] After tax year 2005 this percentage is 25%.

[21] After tax year 2005 this percentage is 50%.

[22] "Quality child care services" are defined as services for care provided at a child care site that meets minimum licensing standards; is accredited by an independent, nationally recognized program approved by the Maine Department of Human Services, Office of Head Start and Child Care; utilizes recognized quality indicators for child care services approved by the Maine Department of Human Services, Office of Head Start and Child Care; and includes provisions for parent and client input, a review of the provider's policies and procedures, a review of the provider's program records, and an on-site program review.

[23] Maryland's top tax rate is 4.75%.

Appendix A (Continued)

State	Basic Provision	Eligible Expenses	Refundable	Maximum: One Child/ Dependent	Maximum: Two or More Children/ Dependents
MA	A *deduction*[24] of eligible expenses.[25]	Expenses eligible for the federal CADC credit, except that expenses are limited to $4,800 for one child or dependent and $9,600 for two or more children or dependents.	No	$254	$509
MN	A *credit*, for tax filers with income no greater than $20,420, equal to the federal CADC credit for which the tax filer is "eligible," up to a maximum of $720 for one child or dependent and a maximum of $1,440 for two or more children or dependents.[26] For tax filers with income over $20,420, the maximum credit is reduced by $18 for every additional $350 of income if one child or dependent, or $36, if two or more children or dependents. No credit is allowed if income exceeds $34,070. The income limitations are indexed for inflation.	Expenses eligible for the federal CADC credit.	Yes	$720	$1,440

[24] Massachusetts has a 5.3% tax rate for all income levels. It also has an optional, voluntary 5.85% tax rate for all income levels. For tax filers who elect this option, the maximum value of the deduction is $281 for one child or dependent and $562 for two or more children or dependents.

[25] Eligible tax filers must choose between this deduction and a second deduction, which is not based on employment-related expenses, for families with one or more children under age 12, a dependent age 65 or older, or a disabled dependent.

[26] These maximum credit amounts prevent the lowest-income Minnesota tax filers from benefiting fully from the improvements to the federal credit in EGTRRA that took effect in tax year 2003 (but, unless extended, expire after tax year 2010).

Appendix A (Continued)

State	Basic Provision	Eligible Expenses	Refundable	Maximum: One Child/ Dependent	Maximum: Two or More Children/ Dependents
MT	A *deduction*[27] of eligible expenses for tax filers with Montana AGI under $22,800, if one child, spouse or dependent, $25,200 if two such individuals, and $27,600 if three or more such individuals.	Expenses necessary for gainful employment for in-home and out-of-home care for: • children under age 15 • spouses physically or mentally incapable of self-care, and • dependents physically or mentally incapable of self-care.[28] Expenses are limited to $2,400 for one child, spouse, or dependent, $3,600 for two such individuals, and $4,800 for three or more such individuals. For tax filers with AGI over $18,000, eligible expenses are reduced by one half of the amount of income over $18,000.	No	$144	$180 for two, $144 for three or more
NE	A *credit* of a specified percentage of the "allowed"[29] federal CADC credit as follows: • 100% if federal AGI is $22,000 or less • 90% if federal AGI is $22,001 — $23,000 • 80% if federal AGI is $23,001 — $24,000 • 70% if federal AGI is $24,001 — $25,000 • 60% if federal AGI is $25,001 — $26,000 • 50% if federal AGI is $26,001 — $27,000 • 40% if federal AGI is $27,001 — $28,000 • 30% if federal AGI is $28,001 — $29,000 • 25% if federal AGI is over $29,000.	Expenses eligible for the federal CADC credit.	Yes, for tax filers with federal AGI of $29,000 or less	$1,050	$2,100

[27] Montana's top tax rate for tax filers with Montana AGI of $18,000 – the highest AGI level at which a tax filer may claim the full Montana deduction – is 6% for tax filers with one child or dependent, 5% for tax filers with two children or dependents, and 3% for tax filers with three or more children or dependents.

[28] The Montana statute seems to make distinctions between expenses (and, arguably, expense limits) for in-home and out-of-home care for children under age 15 as compared to other dependents. However, the Montana tax form and instructions do not make these distinctions.

[29] The Nebraska statute specifically says that the state credit for tax filers with AGI over $29,000 is based on the amount of the federal credit "allowed," but the refundable credit for tax filers with AGI of $29,000 or less is based on the amount of the federal credit "allowable...whether or not the federal credit was limited by the federal tax liability."

Appendix A (Continued)

State	Basic Provision	Eligible Expenses	Refundable	Maximum: One Child/ Dependent	Maximum: Two or More Children/ Dependents
NM	A *credit* of 40% of eligible child care expenses, reduced, for tax filers with federal tax liability, by the amount of the tax filer's federal CADC credit used to offset federal tax liability.[30] Total credit is limited to $480 if one child, $960 if two children, and $1,200 if three or more children. No credit is allowed if New Mexico modified gross income is over $21,424.[31]	Expenses incurred in New Mexico for gainful employment for in-home and out-of-home care paid to a caregiver in New Mexico for children under age 15, up to $8 per day, per child.	Yes	$480	$960 for two, $1,200 for three or more.
NY	A *credit* of a specified percentage of the "allowable"[32] federal CADC credit as follows: • 110% if NY AGI is $25,000 or less • Between 109% and 100% if NY AGI is $25,001-$39,999 [33] • 100% if NY AGI is $40,000-$50,000 • Between 99.5% and 20.5% if NY AGI is $50,001- $64,999[34] • 20% if NY AGI is $65,000 or more.	Expenses eligible for the federal CADC credit.	Yes[35]	$1,155	$2,310

[30] The New Mexico tax forms and instructions for tax year 2005 do not make clear whether the tax filer must offset against the state credit only the portion of the federal credit claimed for child care expenses, or a portion that may include adult dependent care expenses. In either case, because the required offset decreases the value of the New Mexico credit as the value of the federal credit increases, the improvements to the federal credit in EGTRRA that took effect in tax year 2003 (but, unless extended, expire after tax year 2010) decrease the value of the New Mexico credit.

[31] The New Mexico statute says that this amount is set at "not more than the annual income that would be derived from earnings at double the federal minimum wage."

[32] The New York statute specifically says that the state credit is based on the amount of the federal credit allowable, "without regard to whether the tax filer in fact claimed the [federal] credit."

[33] For tax filers with New York AGI between $25,001 and $39,999, the applicable percentage of the federal credit is 100% + 10%[($40,000-AGI)/$15,000]. This formula results in a scale that slides from 109% to 100%.

[34] For tax filers with New York AGI between $50,001 and $64,999, the applicable percentage of the federal credit is 20% + 80% [($65,000-AGI)/$15,000]. This formula results in a scale that slides from 99.5% to 20.5%.

[35] The New York credit is refundable for residents only. For part-year residents, a proportional formula allows them to receive part of the credit as a refund.

Appendix A (Continued)

State	Basic Provision	Eligible Expenses	Refundable	Maximum: One Child/ Dependent	Maximum: Two or More Children/ Dependents
NC	A *credit* of a specified percentage of eligible expenses, as follows: • For children under age 7 and other qualifying dependents incapable of self-care: · 13% if federal AGI is 0-$25,000, depending on the filing status of the tax filer · 11.5% if federal AGI is $12,501-$40,000, depending on the filing status of the tax filer · 10% if federal AGI is $20,000-$40,000 and over, depending on the filing status of the tax filer. • For children age 7 and over: · 9% if federal AGI is 0-$25,000, depending on the filing status of the tax filer · 8% if federal AGI is $12,501-$40,000, depending on the filing status of the tax filer · 7% if federal AGI is $20,000-$40,000 and over, depending on the filing status of the tax filer.	Expenses eligible for the federal CADC credit, except that expenses are limited to $2,400 for one child or dependent and $4,800 for two or more children or dependents.[36]	No	$312	$624
OH	A *credit* of a specified percentage of the federal credit for which the tax filer is "eligible,"[37] as follows: • 100% if Ohio AGI is less than $20,000 • 25% if Ohio AGI is $20,000-$39,999. No credit is allowed if Ohio AGI is $40,000 or more.	Expenses eligible for the federal CADC credit.	No	$1,050	$2,100

[36] These expense limitations prevent North Carolina tax filers from taking advantage of the improvements to the federal credit in EGTRRA that took effect in tax year 2003 (but, unless extended, expire after tax year 2010).

[37] The Ohio statute specifically states that the state credit is based on the amount of the federal credit for which the tax filer is eligible, "without regard to any limitation imposed by [the federal credit's non-refundability provision]."

Appendix A (Continued)

State	Basic Provision	Eligible Expenses	Refundable	Maximum: One Child/ Dependent	Maximum: Two or More Children/ Dependents
OK	A *credit* of 20% of the "allowed" federal "credit for child care expenses," except that if Oklahoma AGI is less than federal AGI, the Oklahoma credit is prorated based on the ratio that Oklahoma AGI bears to federal AGI.	Expenses eligible for the federal CADC credit.[38]	No	$210	$420
OR	A *credit* equal to a specified percentage of expenses "allowable"[39] for the federal CADC credit as follows: • 30% if federal taxable income[40] is $5,000 or less • 15% if federal taxable income is $5,001-$10,000 • 8% if federal taxable income is $10,001-$15,000 • 6% if federal taxable income is $15,001-$25,000 • 5% if federal taxable income is $25,001-$35,000 • 4% if federal taxable income is $35,001-$45,000. No credit is allowed if federal taxable income exceeds $45,000.[41]	Expenses eligible for the federal CADC credit.	No[42]	$900	$1,800

[38] It is unclear from the Oklahoma statute and forms for tax year 2005 whether care expenses other than for children are eligible for the credit.

[39] The Oregon statute specifically states that the state credit is based on an amount of employment-related expenses allowable under the federal credit, "notwithstanding the limitation imposed by [the federal credit's nonrefundability provision]."

[40] Federal taxable income is federal adjusted gross income less federal exemptions and deductions.

[41] Eligible tax filers may claim both this credit and the following "working family child care" credit.

[42] However, if the Oregon credit exceeds the income tax due, the unused amount of the credit may be carried forward as a credit against tax liability in subsequent years, for up to five years.

Appendix A (Continued)

State	Basic Provision	Eligible Expenses	Refundable	Maximum: One Child/ Dependent	Maximum: Two or More Children/ Dependents
OR	A "working family child care" *credit* of a specified percentage of child care expenses, rounded to the nearest $50, as follows: • 40% of eligible expenses if federal AGI is 200% of federal poverty level or less; • 36% if federal AGI is 201%-210% • 32% if federal AGI is 211%-220% • 24% if federal AGI is 221%-230% • 16% if federal AGI is 231%-240% • 8% if federal AGI is 241%-250%.[43] No credit is allowed if federal or Oregon AGI is above 250% of federal poverty level, if investment income is more than $2,700 or if Oregon earned income is less than $6,900.[44]	Expenses (without a dollar limitation) incurred for care provided to a child under age 13 or to an older disabled child if the care allows a tax filer to be gainfully employed, seek employment, or attend school on a full-time or part-time basis.	Yes	No dollar limit[45]	No dollar limit[46]
RI	A *credit* of 25% of the federal CADC credit.	Expenses eligible for the federal CADC credit.	No	$263	$525
SC	A *credit* of 7% of eligible expenses.	Expenses eligible for the federal CADC credit, except that only expenses that are "directly attributable to items of South Carolina gross income" qualify for the credit.[47]	No	$210	$420

[43] Depending on household size, the maximum AGI limits of 250% of poverty range from $23,900 (one-person household) to $81,000 (eight-person household) for tax year 2005.

[44] This amount is indexed for inflation. The earned income test also cannot exceed the amount an individual would earn if the individual worked 1,040 hours at the Oregon minimum wage. At the current Oregon minimum wage of $7.50/hour, this amount would be $7,800.

[45] With expenses at $3,000, the limit in most states, the maximum benefit would be $1,200.

[46] With expenses at $6,000, the limit in most states, the maximum benefit would be $2,400.

[47] The instructions to the South Carolina forms for tax year 2005 do not explain or reference this qualifying language but rather instruct the taxpayer to compute the credit by multiplying the expenses claimed for the federal CADC credit by .07.

Appendix A (Continued)

State	Basic Provision	Eligible Expenses	Refundable	Maximum: One Child/ Dependent	Maximum: Two or More Children/ Dependents
VT	A *credit* of 24% of the "allowed" federal CADC credit.[48]	Expenses eligible for the federal CADC credit.	No	$252	$504
VT	A "low-income CADC *credit*" of a specified percentage of the "allowed" federal CADC credit as follows: • 50% if federal AGI is less than $30,000, if single • 50% if federal AGI is less than $40,000, if married.	Expenses eligible for the federal CADC credit, except that the expenses must be for services provided in a Vermont "registered home or licensed facility certified by the agency of human services as meeting national accreditation or national credential standards endorsed by the agency."	Yes	$525	$1,050
VA	A *deduction*[49] of expenses equal to the amount of expenses on which the federal CADC credit is based.	Expenses eligible for the federal CADC credit.	No	$173	$345

[48] Eligible tax filers may claim either this credit or the following low-income CADC credit, but not both.

[49] Virginia's top tax rate is 5.75%.

Appendix B — State Child and Dependent Care Tax Provisions: Tax Year 2005

State	Citation
Arkansas	Ark. Code Ann. §26-51-502 (Michie, WESTLAW through 2005 Reg. Sess. of 85th Gen. Assemb. & Nov. Gen. Election, including changes made by Ark. Code Revision Comm'n as a result of 2005 Reg. Sess.)
California	Cal. Rev. & Tax Code §17052.6 (West, WESTLAW through Ch. 5 of 2006 Reg. Sess. urgency legislation)
Colorado	Colo. Rev. Stat. §39-22-119 (West, WESTLAW through end of 2005 1st Reg. Sess. of 65th Gen. Assemb.)
Delaware	Del. Code Ann. tit. 30, §1114 (WESTLAW through 75 Del. Laws, Ch. 227)
District of Columbia	D.C. Code Ann. §47-1806.4(c) (WESTLAW through Dec. 9, 2005)
Hawaii	Haw. Rev. Stat. Ann. §235-55.6 (Michie, LEXIS through all 2005 legislation)
Idaho	Idaho Code §63-3022D (Michie, WESTLAW through 2005 Legis. Sess.)
Iowa	Iowa Code Ann. §422.12C (West, WESTLAW through Acts of 2005 1st Reg. Sess.)
Kansas	Kan. Stat. Ann. §79-32, 111a (WESTLAW through 2004 Reg. Sess.)
Kentucky	Ky. Rev. Stat. Ann. §141.067 (Michie, WESTLAW through end of 2005 Reg. Sess.)
Louisiana	La. Rev. Stat. Ann. 47:297.2 (West, WESTLAW through 2005 Reg. and 1st Extraordinary Sess. Acts) (household expense credit) La. Rev. Stat. Ann. 47:297.4 (West, WESTLAW through 2005 Reg. and 1st Extraordinary Sess. Acts) (child care credit)
Maine	Me. Rev. Stat. Ann. tit 36, §5218 (West, WESTLAW through 2006 2nd Spec. Sess. of 122nd Leg.), amended by Act of Mar. 29, 2006, PL 2006, ch. 519, Pt. DD.
Maryland	Md. Code Ann., Tax-Gen. §10-716 (WESTLAW through Ch. 16 of 2006 Reg. Sess.) (credit) Md. Code Ann., Tax-Gen. §10-208(e) (WESTLAW through Ch. 16 of 2006 Reg. Sess.) (deduction)
Massachusetts	Mass. Gen. Laws Ann. ch. 62, §3(B)(a)(7) (West, WESTLAW through 2005 1st Ann. Sess. and through Ch. 10 of 2006 2nd Ann. Sess.)

Appendix B — State Child and Dependent Care Tax Provisions: Tax Year 2005 (cont'd)

State	Citation
Minnesota	Minn. Stat. Ann. §290.067 (West, WESTLAW through 2005 1st Spec. Sess.)
Montana	Mont. Code Ann. §15-30-121 (WESTLAW through 2005 Reg. Sess. of 59th Legis.)
Nebraska	Neb. Rev. Stat. §77-2715.07(2)(a),(b) (WESTLAW through 1st Reg. Sess. of 99th Legis. (2005))
New Mexico	N.M. Stat. Ann. §7-2-18.1 (Michie, WESTLAW through Ch. 3 (End) of 1st Reg. Sess. of 47th Legis. (2005) (including Const. Amendments 1 and 2))
New York	N.Y. Tax Law §606(c) (McKinney, WESTLAW through 2006 Laws, ch. 1-6, and 8)
North Carolina	N.C. Gen. Stat. §105-151.11 (WESTLAW through 2006 Reg. Sess.)
Ohio	Ohio Rev. Code Ann. §5747.054 (West, WESTLAW though 2006 File 75 of 126th Gen. Assemb.)
Oklahoma	Okla. Stat. Ann. tit. 68, §2357(B)(2) (West, WESTLAW through Ch.1 of 2005 1st Extraordinary Sess.)
Oregon	Or. Rev. St. §316.078 (WESTLAW through end of 2003 Reg. Sess. Updated to include section numbers assigned by Or. Legis. Counsel to sections newly enacted in 2005 by 1st Reg. Sess. of 73rd Legis. Assemb.) (CADC credit) Or. Rev. St. §315.262 (WESTLAW through end of 2003 Reg. Sess. Updated to include section numbers assigned by Or. Legis. Counsel to sections newly enacted in 2005 by 1st Reg. Sess. of 73rd Legis. Assemb.), amended by 2005 Or. Laws ch. 832, S.B. 31 (WFCC credit)
Rhode Island	R.I. Gen. Laws §44-30-2.6(d)(2) (WESTLAW through Jan. 2005 Sess.)
South Carolina	S.C. Code Ann. §12-6-3380 (Law. Co-op, WESTLAW though end of 2005 Reg. Sess.)
Vermont	Vt. Stat. Ann. tit. 32, §5822(d) (WESTLAW through 1st Sess. of 68th Biennial Sess. (2005)) (CADC credit) Vt. Stat. Ann. tit. 32, §5828(c) (WESTLAW through 1st Sess. of 68th Biennial Sess. (2005)) (LICADC credit)
Virginia	Va. Code Ann. §58.1-322(D)(3) (Michie, WESTLAW through end of 2005 Reg. Sess.)

Notes

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11 Dupont Circle, NW
Suite 800
Washington, DC 20036
202/588-5180 • Fax: 202/588-5185
www.nwlc.org