Improving the Child and Dependent Care Tax Credit Would Help Working Families and Promote Tax Fairness for Women

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Congressional tax-writing committees have undertaken a comprehensive review of the federal tax code, including federal tax credits for working families such as the Child and Dependent Care Tax Credit (CDCTC). For nearly 60 years, Congress has recognized that the child care expenses parents incur in order to earn income should be acknowledged in the tax code.[1] This review provides an opportunity to strengthen and improve the CDCTC to reflect the needs of the increased number of mothers of young children in the labor force and the rising costs of child care.

Parents struggle to afford the child care they need to go to work and their children need for healthy development.

Child care is a major expense for working families, especially those with low incomes. Lower-income families have the greatest need for child care assistance, as child care consumes a higher percentage of their budgets. Families who pay for child care spend, on average:

- 30 percent of their incomes on child care if their incomes are below the poverty level;
- 18 percent if their incomes are between 100 and 200 percent of the poverty level; and
- 6 percent if their incomes are at or above 200 percent of the poverty level.[2]

The high cost of child care can discourage women's full participation in the labor force.

Child care expenses can represent a particular barrier to women's participation in the paid labor force, because they consume a substantially larger share of the income of employed mothers than they do of family income overall. The cost of child care relative to the income of working mothers in families who pay for child care is, on average:

- 38 percent of their incomes if their incomes are below the poverty level;
- 28 percent if their incomes are between 100 and 200 percent of the poverty level; and
- 16 percent if their incomes are at or above 200 percent of the poverty level.[3]

For mothers with children under age 5, child care consumes an even larger share of their income:

- 43 percent, for mothers with incomes below the poverty level;
- 33 percent, for mothers with incomes between 100 and 200 percent of the poverty level; and
- 21 percent, for mothers with incomes at or above 200 percent of the poverty level.[4]

The current CDCTC provides limited benefits to low-income families because it is not refundable.

In 2011, the CDCTC provided $3.5 billion in child care assistance to 6.4 million families.[5] However, even though on paper the lowest-income families are eligible for the largest credit, they receive only a small share of the tax benefits,[6] because the credit can only be used to offset federal income tax liability.

The CDCTC allows parents to claim a percentage of their work-related child and dependent care expenses toward the credit: up to $3,000 for one child or dependent, and up to $6,000 for two or more children or dependents. The percentage of eligible expenses that a family may claim declines with income. Families with an Adjusted Gross Income (AGI) of $15,000 or less are eligible for a credit equal to 35 percent of eligible expenses. The rate decreases as AGI increases above $15,000 until it reaches 20 percent for families with AGIs above $43,000.

Thus, in theory, families with AGI of $15,000 or less are eligible for a maximum credit of $2,100—while families with incomes above $43,000 are eligible for a maximum credit of $1,200. However, because the CDCTC is not refundable, many low-income families get little or no benefit from the credit. For example, assuming these families claim the standard deduction and appropriate personal exemptions:

- A single mother with two children, an AGI of $15,000, and child care expenses of $6,000 is theoretically entitled to the maximum CDCTC of $2,100. However, her federal income tax liability, before credits, is zero, so she is not eligible for any benefit.
- A married couple with two children, an AGI of $25,000, and child care expenses of $6,000 is theoretically entitled to a CDCTC of $1,800. But they would receive nothing because their federal income tax liability is zero.
- A single mother with two children, an AGI of $25,000, and child care expenses of $6,000 is theoretically entitled to a CDCTC of $1,800. Her federal income tax liability, before credits, is $435, so that is the maximum she can claim from the CDCTC.
- A married couple with two children, an AGI of $35,000, and child care expenses of $6,000 is theoretically entitled to a CDCTC of $1,500. Their federal income tax liability, before credits, is $720, so that is the maximum they can claim from the CDCTC.

The current CDCTC loses value over time because its parameters are not indexed for inflation.

- The child care expense limits, currently $3,000 for one child or dependent and $6,000 for two or more children or dependents, are not indexed for inflation. They were last increased in 2001 and do not reflect the current costs of child care.[7]
- The sliding scale, last increased in 2001, starts reducing the credit at an AGI of $15,001 and phases down to its minimum level at $43,001. It also is not indexed for inflation. As a result, the credit starts shrinking when family income is well below the federal poverty guidelines for a family of three in 2013,[8] and provides a diminished tax benefit to moderate-income families who may not be eligible for any other type of child care assistance.[9]

The federal CDCTC should be improved to help the families who need it most.

There are several ways to improve the CDCTC to help families who struggle to pay for the child care they need to earn a living:

- **Make the CDCTC refundable.** This crucial reform would allow many low-income working families to claim the credit for the first time and would increase the value of the credit for many moderate-income families.
- **Increase the percentage of expenses that low- and moderate-income families may claim.** Increasing the percentage of expenses that the lowest-income families can claim and raising the income level at which the phase-down begins would increase tax assistance to families who most need help paying for child care.

- **Increase the child care expense limits.** An adjustment would reflect the rise in the cost of child care and help families at all income levels whose expenses exceed the current limits.
- **Index the expense limits and income levels on the sliding scale for inflation.** This would prevent the value of the credit from eroding over time.

Improving the CDCTC would significantly promote tax equity for women.

Women continue to bear the bulk of responsibility for care of children and adult dependents. Tax provisions that help pay for child and dependent care relieve women of some of the burden of unpaid caregiving and lessen barriers to women's participation in the workforce, helping them support themselves and their families.

1 In 1954, the tax code provided a deduction for certain work-related child care expenses; the deduction was converted to a credit in 1976 and increased in 1981 and 2001.

2 U.S. Census Bureau, Who's Minding the Kids? Child Care Arrangements: Spring 2011 (Apr. 2013), Detailed Tables, Table 6, *available at* http://www.census.gov/hhes/childcare/data/sipp/2011/tables.html.

3 Ibid.

4 Ibid.

5 Internal Revenue Service, Statistics of Income, Preliminary Data for Tax Year 2011, Figure A: Individual Income Tax Returns, Selected Income and Tax Items by Size of Adjusted Gross Income, *available at* http://www.irs.gov/pub/irs-soi/13inwinbulincomeprlim11.pdf (last visited April 9, 2013).

6 Families with incomes below $20,000 received about one percent of the CDCTC tax benefits, and families with incomes between $20,000 and $30,000 received less than ten percent of the CDCTC tax benefits, in 2009. Urban Brookings Tax Policy Center, Expansion of Child and Dependent Care Tax Credit (CDCTC) Returns and Amount Reported Compared to Current Law Assuming 90-Percent Participation Rate, 2009, Table T09-0383, http://www.taxpolicycenter.org/numbers/displayatab.cfm?Docid=2457.

7 *See* NACCRRA, Parents and the High Cost of Child Care 2012 (citing the average cost of child care for infants in child care centers in 2011 as ranging between $4,600 and nearly $15,000; the average cost of child care for four-year-olds in child care centers in 2011 as ranging between $3,900 and nearly $11,700; the average cost of child care for infants in family day care homes as ranging between $4,500 and nearly $10,400; and the average cost of child care for four-year-olds in family day care homes as ranging between $4,100 and about $9,600), *available at* http://www.naccrra.org/sites/default/files/default_site_pages/2012/cost_report_2012_final_081012_0.pdf.

8 Federal Register, Annual Update of the HHS Federal Poverty Guidelines (Jan. 24, 2013) (listing poverty threshold for family of three as $19,530 and for family of four as $23,550), *available at* https://www.federalregister.gov/articles/2013/01/24/2013-01422/annual-update-of-the-hhs-poverty-guidelines.

9 *See* NWLC, Pivot Point: State Child Care Assistance Policies 2013 at 9 (finding that, in 14 states, a family of three earning above $29,295 would be ineligible for child care assistance), *available at* http://www.nwlc.org/sites/default/files/pdfs/final_nwlc_2013statechildcareassistancereport.pdf.