M E M O R A N D U M

To: Individuals and Organizations Interested in Child Care
From: Nancy Duff Campbell, Amy K. Matsui and Jessica Heaven
Date: February 24, 2010
Re: Developments in Federal and State Child and Dependent Care Tax Provisions in 2009

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

This memorandum summarizes changes to state and federal child and dependent care tax provisions that took effect or were enacted or promulgated in 2009. Since the National Women's Law Center's April 2009 update[1] to the April 2006 edition of its quadrennial report, *Making Care Less Taxing: Improving State Child and Dependent Care Tax Provisions*[2] and accompanying state-by-state report card, *Making the Grade for Care*,[3] which evaluated provisions in effect as of the end of 2005, no states enacted new CADC provisions. Only one state, Oregon, enacted changes to an existing CADC provision, which do not affect the provision's value.

At the federal level, as discussed in last year's memo, the definition of "qualifying child" for the purposes of federal child-related tax provisions, including the federal CADC credit, was amended in the Fostering Connections to Success and Increasing Adoptions Act of 2008,[4] effective for tax year 2009. In addition, the American Recovery and Reinvestment Act,[5] ("ARRA") signed on February 17, 2009, contained improvements to federal tax provisions for low- and moderate-income families effective for tax years 2009 and 2010 (including in the Earned Income Tax Credit (EITC),[6] Child Tax Credit (CTC),[7] and a new Making Work Pay Tax Credit[8]). However, the ARRA did not change the federal CADC credit. More information on

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[1] Memorandum from Nancy Duff Campbell, Amy K. Matsui & Arlene Brens, National Women's Law Center, to Individuals and Organizations Interested in Child Care (Apr. 7, 2009 [hereinafter April 2009 update to *Making Care Less Taxing*], *available at* http://www.nwlc.org/pdf/2009%20DCTC%20update%204%207%2009.pdf.
[2] Nancy Duff Campbell et al., Making Care Less Taxing: Improving State Child and Dependent Care Tax Provisions (2006) [hereinafter *Making Care Less Taxing*], *available at* http://www.nwlc.org/pdf/MakingCareLessTaxing2006.pdf.
[3] National Women's Law Center, Making the Grade for Care: Ranking State Child and Dependent Care Tax Provisions (2006), *available at* http://www.nwlc.org/pdf/MakingTheGradeForCare2006.pdf.
[4] Pub. L. No. 110-351, 122 Stat. 3949 (2008), *available at* http://frwebgate.access.gpo.gov/cgi-bin/getdoc.cgi?dbname=110_cong_bills&docid=f:h6893enr.txt.pdf.
[5] Pub. L. No. 111-5, 123 Stat. 115 (2009), *available at* http://www.opencongress.org/bill/111-h1/text.
[6] Pub. L. No. 111-5, § 1002, 123 Stat. at 312.
[7] Pub. L. No. 111-5, § 1003, 123 Stat. at 313.
[8] Pub. L. No. 111-5, § 1001, 123 Stat. at 309-10.

the ARRA tax provisions is available on the Center's website.[9] These ARRA tax changes and the expansion of the federal CADC credit enacted in 2001[10] will expire at the end of 2010, if Congress does not act to extend them this year.

Finally, this memorandum reminds advocates of the materials available as part of the Center's Tax Credits Outreach Campaign to help increase the number of families eligible for and claiming these and other child-related federal and state tax provisions. Given the new ARRA tax benefits available this year to help meet the increased needs of many families, it is important to make sure that families know about these provisions so they can claim them when they file their taxes in early 2010.

Changes to State Law Enacted in 2009

As mentioned above, no states enacted new CADC tax provisions. Oregon enacted legislation modifying its existing Working Family Child Care Tax Credit (WFCC tax credit).[11] The legislation made two changes in the definition of "qualifying child" for the purposes of the WFCC tax credit, effective for tax year 2009. One change eliminates the ability of a noncustodial parent to claim the WFCC credit. The other allows the WFCC credit to be claimed on behalf of children who provide more than half of their own support.

Under prior Oregon law, the WFCC tax credit could be claimed by either a custodial divorced or separated parent[12] or a noncustodial divorced or separated parent who was eligible to claim the federal dependency exemption for a child because the custodial parent released that parent's right to claim that exemption, assuming both met the other requirements for the credit.[13] In contrast, under federal law, only the custodial parent may claim a child for the federal CADC credit, even if the noncustodial parent claims the child for the dependency exemption.[14] Pursuant to the 2009 legislative changes in Oregon, a noncustodial parent may no longer claim the WFCC tax credit, making the WFCC credit consistent in this regard with the federal CADC credit. It is unclear what the actual impact of this change will be.

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[9] National Women's Law Center, Family Tax Credits in the American Recovery and Reinvestment Act of 2009 (2009), *available at* http://www.nwlc.org/pdf/Family_Tax_Credits_in_ARRA.pdf.

[10] Economic Growth and Tax Relief Reconciliation Act, Pub. L. No. 107-16, § 204(a), (b), 115 Stat. 38, 49 (2001) (codified as amended at 26 U.S.C. § 21(a)(2), (c) (West, Westlaw through P.L. 111-138 (excluding P.L. 111-136) approved 2-1-10)). *See infra* note 18.

[11] 2009 Or. Laws ch. 909, § 41 (codified at Or. Rev. Stat. § 315.262 (West, Westlaw through End of the 2009 Reg. Sess.)).

[12] Under federal law, a child is in the custody of one or both parents for more than one-half the year if one or both parents has "the right under state law to physical custody of the child for more than one-half the year." 26 C.F.R. § 1.152-4(c). As between the two parents, the"custodial parent" is "the parent with whom a child shared the same principal place of abode for the greater portion of the calendar year," and the noncustodial parent is the parent who is not the custodial parent. 26 U.S.C. §§ 152(e)(3)(A), (B). The Oregon WFCC statute incorporates the federal definitions of "custodial parent" and "noncustodial parent" by its reference to 26 U.S.C. § 152 (which sets forth the requirements for claiming a child as a qualifying child for the federal dependency exemption). *See* Or. Rev. Stat § 315.262 (West, Westlaw through End of the 2007 Reg. Sess.), *amended by* 2009 Or. Laws ch. 909, § 41.

[13] Or. Rev. Stat § 315.262 (West, Westlaw through End of the 2007 Reg. Sess.), *amended by* 2009 Or. Laws ch. 909, § 41; *see also* Or. Dep't of Revenue, 2008 Oregon Income Tax Full-Year Resident Form 40, Form 40S, Schedule WFC, and Instructions 38 (2008), *available at* http://www.oregon.gov/DOR/PERTAX/docs/2008Forms/101-043-08.pdf.

[14] 26 U.S.C. § 21(e)(5) (West, Westlaw through P.L. 111-138 (excluding P.L. 111-136) approved 2-1-10).

The second change to the WFCC tax credit concerns children who provide over one-half of their own support. Oregon law previously followed federal law in prohibiting a child who provided over one-half of his or her own support from being claimed as a qualifying child.[15] Such "support" includes certain kinds of government benefits paid specifically on the child's behalf, such as children's Social Security benefits, as well as the child's own earnings.[16] Under the 2009 legislative change in Oregon, however, this "support" test is eliminated for the WFCC credit.[17] Although this change distinguishes the WFCC tax credit from the federal CADC credit, it simplifies applying for the WFCC credit and may increase the number of children who are considered qualifying children under it.

Potential Changes to Federal Law in 2010

As noted above, improvements to the federal CADC credit that were enacted in 2001,[18] along with many other changes to tax policy, are scheduled to expire at the end of 2010 unless Congress acts. If the 2001 improvements are allowed to expire, the value of the federal CADC credit would decrease substantially for millions of families. In addition, the many state CADC tax provisions that are linked to the federal credit[19] would also automatically decrease in value.

In its budget for FY 2011, the Obama Administration proposed making the 2001 improvements to the federal CADC credit permanent. It also proposed an increase in the CADC credit for families with incomes between $15,000 and $85,000 per year. Families with incomes up to $113,000 per year would receive some benefit from the Administration's new proposal. Several bills were introduced in both the House of Representatives and the Senate in 2009 that would also improve the federal CADC credit.[20] Some of the improvements in these bills were also proposed by President Obama during his presidential campaign, including the most significant improvement for low-income families, which would be to make the credit

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[15] *See* § 152(c)(1)(D).

[16] *See* Internal Revenue Serv., Publication 501: Exemptions, Standard Deduction, and Filing Information 18 (2009), *available at* http://www.irs.gov/pub/irs-pdf/p501.pdf.

[17] *See* 2009 Or. Laws ch. 909, § 41 (codified at Or. Rev. Stat. § 315.262 (West, Westlaw through End of the 2009 Reg. Sess.)).

[18] The Economic Growth and Tax Relief Reconciliation Act (EGTRRA) increased the expense limits from $2,400 for one child or dependent and $4,800 for two or more children or dependents to $3,000 for one child or dependent and $6,000 for two or more children or dependents. EGTRRA, Pub. L. No. 107-16, § 204(a), 115 Stat. 38, 49 (2001) (codified as amended at 26 U.S.C. § 21(c) (West, Westlaw through P.L. 111-138 (excluding P.L. 111-136) approved 2-1-10)). In addition, Congress increased the maximum percentage of eligible expenses a taxpayer may claim from 30% to 35% of expenses, and increased the AGI at and below which a taxpayer may claim the maximum percent of qualifying expenses from $10,000 to $15,000, and the AGI above which a taxpayer may claim the minimum 20% of expenses from $28,000 to $43,000. EGTRRA § 204(b). As a result of these changes, which were effective in tax year 2003, the maximum potential credit amount increased from $1,440 to $2,100.

[19] Eighteen states calculate their CADC credits as a percentage of the federal CADC credit, four states provide a tax deduction for expenses eligible for the federal credit, and four states provide a tax credit whose amount is a percentage of the expenses eligible for the federal credit. *See Making Care Less Taxing*, *supra* note 2, at 14-17; April 2009 Update to *Making Care Less Taxing*, *supra* note 1, at 2.

[20] *See, e.g.,* Family Tax Relief Act of 2009, S. 997, 111th Cong. (2009); Right Start Child Care and Education Act of 2009, H.R. 460/ S. 210, 111th Cong. (2009).

refundable.[21] However, the Administration's FY 2011 budget proposal would not make the CADC credit refundable.

The budget proposal and these bills present a real opportunity this year to both protect and improve the value of the federal CADC credit. If you are interested in joining in advocacy efforts related to the federal CADC credit, please contact Rio Romero (rromero@nwlc.org).

Although the last full update of the Center's quadrennial report on child and dependent care tax provisions was completed in 2006, the Center will not be updating *Making Care Less Taxing* until 2011 because of the potential for changes to the federal CADC credit in 2010.

The Center's Tax Credits Outreach Campaign for Tax Year 2009

Each year, the Center conducts a national Tax Credits Outreach Campaign in partnership with state advocates and service providers to help families take advantage of federal and state child and dependent care tax provisions and other valuable tax benefits. Campaign partners work to get the word out to families through child care services and other networks, the media, large employers, and state agencies. Similar campaigns in previous years have increased significantly the number of families claiming these tax benefits and the benefits they receive. Tax credits outreach efforts are particularly important this year because of the ARRA improvements to federal credits and corresponding increases to some state credits.

To help with these campaigns, the Center has prepared materials to inform families about the benefits available for tax year 2009 from the federal CADC credit, EITC, CTC, and the new Making Work Pay Credit, including fliers that are available in English and Spanish, and in some instances, in Vietnamese and Chinese. The Center has also prepared state-specific fliers in English and Spanish for every state, and a variety of other informational and campaign materials.

You can help spread the word to eligible families by distributing outreach fliers, including an article about tax credits in your newsletter, or linking to the Center's tax credits outreach web page on your own website. To find out more about how you can spread the word about valuable federal and state tax benefits, check out the Center's Toolkit for Child Care Advocates.

In addition, this year, the Center invites you to become a Community Partner in the Center's campaign. The Center is providing to its Community Partners tailored materials, including media materials, and technical assistance upon request. The current list of Community Partners is available on the Center's tax credits outreach campaign web page. To sign up to be a Community Partner, please visit http://action.nwlc.org/communitypartner or contact Melanie Ross Levin at mrosslevin@nwlc.org.

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[21] The federal CADC credit is not refundable, meaning that families must have federal tax liability in order to take advantage of it. Because families on the lower end of the income scale, who are theoretically eligible for the more generous federal CADC credit, generally have little or no federal income tax liability, they are likely to receive little or *no* benefit from the credit. *See* National Women's Law Center, An Expanded and Refundable Child and Dependent Care Tax Credit Would Help Make Child Care More Affordable for Millions of Families (2009), *available at* http://www.nwlc.org/pdf/CDCTCFactsheet2009.pdf.

Conclusion

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