Making Care Less Taxing

Improving State Child and Dependent Care Tax Provisions

20 Subtract line 19 from line 17. If line 19 is more than line 17, enter 0.
21 Multiply $2,650 by the total number of exemptions claimed on line 6a.
22 Subtract line 21 from line 20. If line 21 is more than line 20, enter 0. This is your taxable income. If you want the IRS to figure your tax, see page 24.
23 Find the tax on the amount on line 22 (see page 24).
24a Credit for child and dependent care expenses. Attach Schedule 2a.
24b Credit for the elderly or the disabled. Attach Schedule 3.
24c Adoption credit. Attach Form 8839.
24d Add lines 24a, 24b, and 24c. These are your total credits.
25 Subtract line 24d from line 23. If line 24d is more than line 23, enter 0.
26 Advance earned income credit payments from Form(s) W-2.
27 Household employment taxes. Attach Schedule H.
28 Add lines 25, 26, and 27. This is your total tax.
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, family support and income security—with special attention given to the needs of low-income women. Janice Steinschneider, the principal author of this report when it was first published in 1994, is a Washington, D.C. attorney experienced in women's economic and reproductive health issues. Elisabeth Hirschhorn Donahue, who updated this report in 1998, is an attorney experienced in child care and child support issues and former Staff Counsel at the National Women's Law Center. Nancy Duff Campbell is Co-President and Verna L. Williams is Senior Counsel at the National Women's Law Center.
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April, 1998

NATIONAL WOMEN’S LAW CENTER
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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 about 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 well-being.

This report is designed to help state policymakers and advocates rectify this situation and assist them in developing the best child and dependent care (CADC) income tax provisions possible for their states. 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 tax year 1997. Finally, the report identifies policy decisions commonly made when enacting and implementing a CADC income tax provision and makes recommendations designed to help policymakers 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 that put a severe strain on the

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1/ A “report card” grading state child and dependent care tax provisions according to a point system based on the best state policies, Making the Grade for Care: Ranking State Child and Dependent Care Tax Provisions, accompanies this report.
family budget. Indeed, families with a preschool-age child who pay for care spend between 6 and 25 percent of their family income on child care—comparable to the 12.5 percent of their family income spent on food. The average weekly cost of care for families with a preschool-age child who pay for care was $79—or $4,100 per year, in 1993. Employment-related care expenses for adult dependents can also be very high. The average cost of adult day care varied from a low of $16.50 per day in New Hampshire to a high of $54 per day in California in 1995—$4,290 and $14,040 a year, respectively. 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 taxpayers according to their ability to pay is a cornerstone of tax fairness. A family that earns $25,000 a year but must spend $3,000 for child care in order to earn that income has less available income than a family that earns $25,000 and has no employment-related 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.


3/ Lynn M. Caspar, U.S. Dept of Commerce, What Does it Cost to Mind Our Preschoolers?, Table 3 (1995). The burden on lower-income families is especially great: 25 percent of family income is spent on child care by families with incomes under $14,000, whereas 6 percent of family income is spent by families with incomes of $54,000 and over. Id.


5/ Caspar, supra note 3, figure 2. In 1990, the most recent year for which data are available, the average cost of care for a child age five to twelve years old was $1,900 per year, or a little over half of the average cost of care for a preschooler that year. Sandra L. Hofferth et al., National Child Care Survey, 1990, at 145 (1991).

6/ Charlene Harrington et al., 1995 State Data Book on Long Term Care: Program and Market Characteristics 33, 133 (1996). These average costs are based on Medicaid reimbursement rates and vary from state to state. Adult day care programs generally provide health, social, personal care, and related support services for functionally or mentally impaired adults.
• **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 more money.\(^7\) Care payments go toward making facilities safe and providing activities, equipment, and staff ratios that promote children’s and adults’ development. Another key factor in quality care is maintaining low staff turnover, which is only possible when care workers are paid a salary that reflects their education, experience, and skills.\(^8\) 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. Assistance with employment-related care is especially important for single mothers, who are more likely to be poor than married couples or single fathers.\(^9\) In addition, by enabling families to pay more for care, CADC tax provisions can raise the income of child and dependent care workers, who are mostly women and are grossly underpaid.\(^10\)

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7/ For example, in 1990, the most recent year for which data are available, the average cost of child care in full-day, full-year, center-based programs for four-year-olds accredited by the National Association for the Education of Young Children was $4,797. U.S. General Accounting Office, *Early Childhood Education: What Are The Costs of High Quality Programs?* (1990).


II. The Federal Child and Dependent Care Tax Credit

The federal tax code has had a child and dependent care tax credit since 1976, usually referred to as the dependent care credit. Under the credit, a portion of employment-related expenses is subtracted from the taxpayer’s 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 credit has the following key features:

- **Employment-related expenses for both children and adult dependents are covered.** Under the federal credit’s current provisions, employment-related expenses for the care of children under the age of thirteen who live with the taxpayer may be claimed. Formerly, expenses for children under age fifteen were covered; Congress lowered the age limit for tax years beginning in 1989. Also eligible for the credit are employment-related expenses for the care of spouses and dependents age thirteen and older who live with the taxpayer and are incapable of self-care.

- **Care both in and out of the home is covered.** The federal law allows families to claim the tax credit for both in-home and out-of-home care arrangements. A limitation is that expenses for out-of-home care for spouses and dependents age thirteen and older who are incapable of self-care may be claimed only if the spouse or dependent spends at least eight hours a day in the taxpayer’s household. This prevents families from receiving the credit for institutional care.

- **Expenses eligible for the credit are limited.** Families may claim work-related expenses of up to $2,400 for one child or dependent, and up to $4,800 for two or more children or dependents. Any expenses above these amounts are not eligible for the credit.

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11/ The origin of the credit was a 1954 provision establishing a tax deduction for certain employment-related child and dependent care expenses. The deduction was converted to a credit in 1976. The current federal CADC credit is found at 26 U.S.C. § 21.

12/ Employment-related expenses are expenses incurred while the taxpayer is gainfully employed or in active search of gainful employment. If the taxpayer is married, the taxpayer’s spouse must also be employed or looking for employment, unless the spouse is a full-time student or incapable of self-care.

13/ In addition, expenses paid to a “dependent care center,” defined as a facility that provides care for more than six individuals, may be claimed only if the center complies with applicable state and local laws.

14/ In addition, the expenses claimed may not exceed the earned income of the taxpayer or the taxpayer’s spouse, whichever is less.
• The credit targets the greatest amount of assistance to lower-income families. Only a portion of eligible expenses may be taken as a credit, the portion dropping on a sliding scale as the taxpayer’s income rises, from 30 percent to 20 percent. The following chart illustrates the maximum credit amounts at different income levels:

<table>
<thead>
<tr>
<th>Adjusted Gross Income</th>
<th>Percent of Expenses Credited</th>
<th>One Child/Dependent</th>
<th>Two or More Children/Dependents</th>
</tr>
</thead>
<tbody>
<tr>
<td>$0 - 10,000</td>
<td>30%</td>
<td>$720</td>
<td>$1,440</td>
</tr>
<tr>
<td>10,001 - 12,000</td>
<td>29%</td>
<td>696</td>
<td>1,392</td>
</tr>
<tr>
<td>12,001 - 14,000</td>
<td>28%</td>
<td>672</td>
<td>1,344</td>
</tr>
<tr>
<td>14,001 - 16,000</td>
<td>27%</td>
<td>648</td>
<td>1,296</td>
</tr>
<tr>
<td>16,001 - 18,000</td>
<td>26%</td>
<td>624</td>
<td>1,248</td>
</tr>
<tr>
<td>18,001 - 20,000</td>
<td>25%</td>
<td>600</td>
<td>1,200</td>
</tr>
<tr>
<td>20,001 - 22,000</td>
<td>24%</td>
<td>576</td>
<td>1,152</td>
</tr>
<tr>
<td>22,001 - 24,000</td>
<td>23%</td>
<td>552</td>
<td>1,104</td>
</tr>
<tr>
<td>24,001 - 26,000</td>
<td>22%</td>
<td>528</td>
<td>1,056</td>
</tr>
<tr>
<td>26,001 - 28,000</td>
<td>21%</td>
<td>504</td>
<td>1,008</td>
</tr>
<tr>
<td>28,001 +</td>
<td>20%</td>
<td>480</td>
<td>960</td>
</tr>
</tbody>
</table>

• Married couples must file a joint return to be eligible for the credit. 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.

The federal CADC income tax credit is the single largest source of federal child care assistance. According to preliminary data, 6.2 million taxpayers claimed the federal CADC credit and received over $2.7 billion in tax benefits in 1995.15 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.16 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 $600 but only owes $400 in taxes will receive a credit of only $400. If the credit were refundable, the family would receive a tax refund of $200. 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.

16/ The federal tax provision making the federal CADC credit nonrefundable is at 26 U.S.C. § 26.
• 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—were indexed for inflation in 1986. Because the CADC credit’s sliding scale thresholds are not indexed for inflation, however, the targeting to lower-income families provided by the sliding scale has been eroding as fewer and fewer families have incomes low enough to claim the credit’s highest percentages of expenses. For example, for tax year 1997 the tax thresholds for all married couples and heads of household with children are above $10,000, the thresholds for heads of household with two or more children or dependents are above $12,000, and the thresholds for married couples with two or more children or dependents are above $16,000. As these examples illustrate, there are virtually no families eligible for the highest credits of 30–26 percent of their expenses, since even families with only one or two children or dependents do not pay taxes at the income levels eligible for these percentages. 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. When the current expense limits were set in 1981, they reflected the average costs of child care. But they have not been updated since, and are not indexed for inflation. Moreover, they have always been inadequate to cover the high cost of adult day care. As a result, the expense limits of the credit are not reflective of many families’ actual care expenses.

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

Twenty-four states (including the District of Columbia) have CADC income tax provisions. 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 taxpayer’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.

• Fourteen states provide a tax credit whose amount is determined by the amount of the federal credit that the taxpayer is eligible to receive. The states with this type of provision are Arkansas, Colorado, Delaware, the District of Columbia, Iowa, Kansas, Kentucky, Louisiana, Maine, Minnesota, Nebraska, New York, Ohio, and Oklahoma. Typically, the state credit is a percentage of the federal credit. Although this type of provision is the simplest to calculate, its adequacy varies considerably depending on the percentage selected. In the fourteen states with this form of credit, the top percentage ranges from a low of 10 percent to a high of 100 percent; in seven of these states, the top percentage is at or below 25 percent; in seven states the top percentage equals or exceeds 50 percent. Accordingly, the maximum value of the credits in these fourteen states, when Louisiana’s very low child care credit of $25 is excluded, ranges from $144 to $1,440.

• Four states provide a tax deduction for expenses eligible for the federal credit. These states are Idaho, Maryland, Massachusetts, and Virginia. Although

18/ In four of these states—Colorado, Iowa, New York and Ohio—the percentage falls as the income of the taxpayer rises, thereby increasing the targeting to lower-income taxpayers beyond that already provided in the federal credit. Minnesota’s credit, whose amount is determined in part by reference to the federal credit, but is not calculated as a simple percentage of the federal credit, also allows lower-income families to claim a larger credit amount than higher-income families.

19/ Arkansas provides a credit of 10 percent of the federal credit. Louisiana provides a credit for child care of 10 percent of the federal credit, up to a maximum of $25, and a separate credit for the care of dependents who are physically or mentally incapable of self-care of 100 percent of the federal credit. (Hereinafter these credits will be referred to as Louisiana’s “child care credit” or “dependent care credit” when there is a need to distinguish them.) Ohio and Minnesota provide lower-income families with a credit of 100 percent of the federal credit.

20/ These states are Arkansas, Kansas, Kentucky, Louisiana, Maine, Nebraska, and Oklahoma.

21/ These states are Colorado, Delaware, Iowa, Louisiana, Maine, Minnesota, New York, and Ohio.

22/ In Massachusetts, taxpayers must choose between 1) a CADC deduction of up to $2,400 of employment-related expenses for the care of a qualified child under age fifteen or a disabled dependent or spouse, up to $4,800 for two or more of these individuals, or 2) a deduction of $1,200 if at least one dependent member of the household is under age twelve, regardless of whether the family has work-related expenses for the care of the dependent. Because only the Massachusetts CADC deduction is based on child and dependent care expenses, it is the one referenced in this report; it is worth noting, however, that families with a child under age twelve and less than $1,200 in employment-related care expenses will find it more advantageous to claim the other, flat $1,200, deduction.
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. Thus, with top tax rates varying from 8.2 percent in Idaho to 5 percent in Maryland, the maximum value of these four state tax deductions ranges from a high of $394 in Idaho to a low of $240 in Maryland.23

• Three states provide a tax credit whose amount is a percentage of the expenses eligible for the federal credit. These states are North Carolina, Oregon, and South Carolina.24 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. Both North Carolina and Oregon vary the percentage inversely according to income.25 The maximum credits in the states with this type of provision range from a high of $1,440 in Oregon to a low of $336 in South Carolina.

• 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 thereafter reduced for taxpayers with a federal tax liability by subtracting at least a portion of the federal credit amount from the New Mexico credit amount. New Mexico provides a credit of 40 percent of child care expenses, up to $8 per day, per child, with a maximum credit of $1,200. However, the taxpayer must subtract from the amount of the New Mexico credit the portion of the federal child care credit amount applied against federal tax liability to yield the amount of the New Mexico credit that may be claimed.

• 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 percent—with lower-income taxpayers receiving the higher per-

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23/ Maryland’s, Massachusetts’ and Virginia’s deductions yield CADC tax benefits that are among the lowest in the nation; indeed, only Louisiana’s maximum child care credit of $25 is lower than the maximum benefits provided by these states’ deductions.

24/ In Oregon, in addition to a CADC credit, eligible families may take a “working family credit.” New for tax year 1997, this credit is available to taxpayers with qualifying work- or school-related child care expenses for one or more children under age thirteen (or disabled and under age eighteen), income that is less than 200% of the federal poverty level, earnings of at least $6,000, and investment income of no more than $2,200. Taxpayers calculate their credit by taking a percentage—ranging from 8 to 40 percent, depending on income and household size—of their qualifying child care expenses. Unlike the Oregon CADC credit, expenses are limited to those incurred for child care but there is no limit on the amount of expenses that can be claimed. It is impossible to calculate a maximum working family credit, since multiple individual variables, including the ability to claim an unlimited amount of child care expenses, determine the amount of the credit. Because this feature makes the Oregon working family credit difficult to compare to other states’ CADC tax credits, only the Oregon CADC credit is hereinafter referenced in this report.

25/ In South Carolina the percentage is a flat 7 percent; in North Carolina the top percentage is 9 percent of expenses for children age seven and older, 13 percent for children under age seven and all dependents who are incapable of self-care; in Oregon, the top percentage is 30 percent of expenses.
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, 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. The portion of expenses that is deductible depends on the income of the taxpayer, with lower-income taxpayers receiving a larger portion. The maximum tax benefit under the Montana deduction is $336.

The maximum value of all state CADC tax provisions ranges from $25 in Louisiana (for its child care credit) to $1,440 in Louisiana (for its dependent care credit), Minnesota, Ohio and Oregon. The appendix provides state-by-state descriptions, including maximum credit amounts, of each state CADC provision in effect for tax year 1997.

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 policymakers to make as 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 1997 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 policymakers can adopt to address families’ child and dependent care needs. Why should policymakers 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. Furthermore, CADC tax provisions treat employment-related care as a genuine, legitimate working expense and are the most direct way to

26/ 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.
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. Enacting a tax provision may also be more feasible politically.\footnote{27/ State CADC provisions are popular with the voters. The Montana electorate, for example, in a 1994 referendum, rejected the state legislature’s 1993 repeal of the state’s CADC tax deduction.} Finally, CADC provisions assist families in the workforce, a group for whom assistance is often more 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 afford only care that costs less than needed to derive the maximum benefit from a CADC tax provision. CADC tax provisions also do not directly address issues of access to or quality of care, although by enabling families to pay more for care they can indirectly affect both.\footnote{28/ Arkansas has tried to enhance the indirect effect of its CADC tax credit on quality of care by increasing the credit for families with expenses for children ages three to five who are in "developmentally appropriate early childhood programs." Families with such expenses receive a state credit of 20 percent of the federal credit, rather than 10 percent, and for these families the credit is refundable. The Arkansas approach, while interesting, excludes many quality care settings and, because of its age limitation, affects only a portion of children and dependents receiving employment-related care.}

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.

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**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.

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**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. 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 have found that in practice the most generous provisions they could get enacted were based on the federal credit.

One consideration in linking a state provision to the federal credit is the effect of making the federal credit’s features part of the state provision. 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 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 policymakers. Thus, when improvements are made in the federal credit, as, for instance, when the expense limits were revised upward in 1981, they are automatically incorporated into a federally tied state credit. Similarly, when the federal credit is scaled back, as it was in 1988 when Congress lowered the age limit on children whose care expenses were covered from fifteen to thirteen, the coverage of federally linked state provisions is reduced. 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, but doing so then undercuts the main reason for linking the state provision to the federal credit—simplifying the state calculation.

The federal credit’s nonrefundability warrants special attention here. When a state CADC credit is calculated as a percentage or portion of the federal credit—as is the case in fourteen of the twenty-four 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 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 $600 but its federal tax liability is only $400, the family is able to claim a credit of only $400 on its federal return. If the family’s state credit is 25 percent of the federal credit, is the family entitled to take 25 percent of $600—for a state credit of $150? Or only able to take 25 percent of $400—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 fourteen states that calculate the state credit based on a percentage of the federal credit, the statutory provisions of three states—the District of Columbia, Minnesota and Ohio—clearly provide that the state credit is based on the federal credit for which the taxpayer is potentially eligible, without regard to the nonrefundability provision. In contrast, the statutory provision in one state—Kansas—is explicitly limited to a percentage of the amount of the federal credit “allowed against the taxpayer’s federal income tax liability”—that is, the amount of credit actually received. In the remaining states with credits

29/ Massachusetts, for example, provides a deduction for expenses eligible for the federal CADC credit as in effect on January 1, 1988.
based on a percentage of the federal credit, the statutory provision is ambiguous, referring to a percentage of “allowable,” “allowed,” “provided,” or “claimed” federal credit.\(^{30}\) 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.\(^{31}\)

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.

**Best Policy:** In general, state CADC tax provisions should be independent of the federal CADC tax provision, unless it seems very likely that state policymakers will take a less generous approach now and in the future than the federal government. If a state CADC tax provision is tied to the federal provision, the state provision should clearly provide that it is based on the amount of the federal credit for which the taxpayer is eligible regardless of whether the taxpayer’s total federal tax liability permits the taxpayer 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 income tax provision among the families with care-related expenses. The question is how to do that most equitably and efficiently. The more tax assistance that goes to higher-income families, the less 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.

\(^{30}\) These states are Arkansas, Colorado, Delaware, Iowa, Kentucky, Louisiana, Maine, Nebraska, New York, and Oklahoma.

\(^{31}\) The forms and/or instructions in Delaware, Iowa, Kentucky, Louisiana (for its child care credit), Maine and New York direct the taxpayer to apply the percentage to the federal credit before it is limited by the non-refundability provision. In contrast, the forms and/or instructions in Colorado, Nebraska and Oklahoma provide that the percentage is to be applied to the amount of the federal credit actually received. In Arkansas both the forms and instructions are unclear.
There are a number of ways to target CADC tax provisions to lower-income families, which are discussed below.

1. Credits versus Deductions

Of the twenty-four states with CADC tax provisions, nineteen have credits and five have deductions. 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 taxpayers get more benefit from an identical deduction than do lower-income taxpayers. For instance, the value of a deduction of $2,000 of expenses for taxpayers in a 5 percent tax bracket is $100, while for those in a 10 percent bracket it is $200. By contrast, an identical credit produces the same dollar value for lower- and higher-income taxpayers. For instance, a credit of 25 percent of CADC expenses for a family with $2,000 of expenses produces a credit of $500, regardless of the family’s income. Furthermore, such a credit represents a greater portion of tax liability for the lower-income family. Thus, a $500 credit is 50 percent of the tax liability of a lower-income family that owes $1,000 in taxes but only 10 percent 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.

Best Policy: 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.

32/ The states with credits are Arkansas, Colorado, Delaware, the District of Columbia, Hawaii, Iowa, Kansas, Kentucky, Louisiana, Maine, Minnesota, Nebraska, New Mexico, New York, North Carolina, Ohio, Oregon, Oklahoma, and South Carolina. The states with deductions are Idaho, Maryland, Massachusetts, Montana, and Virginia.

33/ One state—Montana—has offset this effect in part by providing a larger deduction for lower-income taxpayers.

34/ For instance, the maximum value of Idaho’s CADC deduction—$394—is greater than the maximum tax benefit provided by the credits of Arkansas, Kansas, Kentucky, Louisiana (for its child care credit), Maine, Nebraska, Oklahoma, and South Carolina.
2. Refundability

Refundability is critical to ensuring that a CADC tax credit provides as much assistance as possible to low-income families.\(^35\) 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 five states—Hawaii, Iowa, Minnesota, New Mexico, and New York\(^36\)—are fully refundable. In Arkansas, the credit is refundable only for expenses for children ages three to five in “developmentally appropriate early childhood programs.” In three states with nonrefundable credits—Colorado, Louisiana and Oregon—taxpayers 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.\(^37\)

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

3. Sliding Scales and Maximum Income Limits

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

- For CADC tax provisions that are not tied to the federal credit, a sliding scale can reduce the proportion of employment–related care expenses that are claimed as a credit or deduction as the taxpayer’s income rises. For example, a state that provides a credit for employment–related care expenses can structure its sliding scale to provide families with incomes below $20,000\(^38\) a credit of 50 percent of their expenses; families with incomes between $20,000 and $30,000 a credit of 35 percent of their expenses; and families with incomes above $30,000 a credit of 20 percent of their expenses. Similarly, a state that provides a deduction for employment–related care expenses can structure its sliding scale to allow families with incomes below $20,000 to deduct 100 percent of their expenses; families with incomes between $20,000 and $30,000 to deduct 80 percent of their expenses; and families with incomes above $30,000 to deduct 60 percent of their expenses.

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\(^{35}\) Refundability is not possible for tax deductions, another reason that deductions are less effective for low-income families.

\(^{36}\) In New York, the credit is refundable only for residents.

\(^{37}\) In Colorado and Oregon, the credits may be carried forward for up to five years. In Louisiana, only the dependent care credit, not the child care credit, may be carried forward, and only to the next succeeding tax year.

\(^{38}\) Two individuals, each working full-time at a minimum-wage job, would together earn slightly over $20,000 annually.
• For state CADC tax provisions that are tied to the federal credit, a sliding scale can reduce the proportion of federal credit or federally allowed expenses that are claimed as the taxpayer’s income rises, thereby providing additional targeting to that provided in the federal credit itself. For example, a state that provides a credit that is a percentage of the federal credit can structure its sliding scale to give families with incomes below $20,000 a credit of 100 percent of their federal credit; families with incomes between $20,000 and $30,000 a credit of 80 percent of their federal credit; and families with incomes above $30,000 a credit of 60 percent of their federal credit. Similarly, a state that provides a credit that is a percentage of federally allowed expenses can structure its sliding scale to give families with incomes below $20,000 a credit of 100 percent of their federally allowed expenses; families with incomes between $20,000 and $30,000 a credit of 80 percent of their federally allowed expenses; and families with incomes above $30,000 a credit of 60 percent of their federally allowed expenses.

All fourteen states whose credits are a portion of the federal credit indirectly incorporate the federal credit’s sliding scale; of these, five—Colorado, Iowa, Minnesota, New York, and Ohio—further target their credits by providing lower-income taxpayers with a credit of a greater proportion of the federal credit than higher-income taxpayers. Of the three states whose credit is a percentage of federal expenses, two—Oregon and North Carolina—use a sliding scale to determine the percentage of expenses that can be claimed. Of the three states whose CADC tax provisions are independent of the federal credit, two—Hawaii’s credit and Montana’s deduction—use a sliding scale.

Some sliding scales phase out any CADC tax benefit for taxpayers whose income is above a certain level. Seven state CADC provisions have such maximum income limits, which range from a low of $20,317 in New Mexico to a high of $60,000 in Colorado. The states that have provided greater amounts of assistance to lower-income families have tended to impose maximum income limits, presumably to conserve resources that would otherwise be spent on higher-income families. Of the ten states whose maximum CADC tax benefits are greater than $500, six have a maximum income limit. And of the six states with refundable credits, three have maximum income limits. However, a maximum income limit runs counter to the principle that employment-related care expenses are a genuine, legitimate work expense for all families and

39/ The other states with maximum income limits are Iowa, Minnesota, Montana, Ohio and Oregon.
40/ These states are Colorado, Delaware, Hawaii, Iowa, Minnesota, New Mexico, New York, North Carolina, Ohio and Oregon.
41/ These states are Colorado, Iowa, Minnesota, New Mexico, Ohio and Oregon.
42/ These states are Arkansas, Hawaii, Iowa, Minnesota, New Mexico and New York.
43/ These states are Iowa, Minnesota and New Mexico.
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. 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:** CADC provisions should use sliding scales to target the greatest amount of benefit to lower-income taxpayers. However, if possible, middle- and even higher-income families with employment-related care expenses should be eligible for some tax benefit. Maximum income limits should not be so stringent that they do not assist families for whom employment-related care expenses are a significant burden.

**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 costs for adults—for instance, disabled adult children or elderly parents—that can be as great if not greater than those for children. Of the twenty-one states that calculate their state credit or deduction based on the federal CADC credit, eighteen incorporate its coverage for care-related expenses for spouses and dependents who are incapable of self-care as well as children. Of the remaining three states, one—Louisiana—provides separate credits and credit amounts for child care and adult dependent care; one—Colorado—expressly limits its credit to child care; and one—Oklahoma—is ambiguous. Of the three states whose CADC tax provisions are independent of the federal provision, only one—New Mexico—limits coverage to children; the other two—Hawaii and Montana—like the federal provision, cover care expenses for spouses and adult dependents as well.

In three states that expressly cover both children and adult dependents in their statutes, the tax forms, the instructions, or both refer to the provision as a

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44/ These states are Arkansas, Delaware, District of Columbia, Idaho, Iowa, Kansas, Kentucky, Maine, Maryland, Massachusetts, Minnesota, Nebraska, New York, North Carolina, Ohio, Oregon, South Carolina and Virginia. 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.

45/ The maximum Louisiana credit for child care is $25; for dependent care it is $1,440.

46/ The Oklahoma statute refers to a “credit” of 20 percent of “the [federal] credit for child care expenses.” Oklahoma’s tax form instructs the taxpayer to take a percentage of the “federal child care credit” but does not indicate whether any portion of that credit attributable to expenses incurred for adult dependent care must be excluded.

47/ As previously noted, the Montana statute is unclear whether its coverage for expenses for adult dependents is limited to expenses that are incurred for care in the taxpayer’s home. However, the Montana tax form indicates that both in-home and out-of-home care are covered for both children and adult dependents.
“child care” credit. This label could mislead taxpayers with expenses for employment-related care of adults, who may assume that the provision covers only children 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.

All state CADC tax provisions, like the federal credit, cover child care expenses for children under a particular age. The federal age limit, formerly fifteen and now thirteen, applies in states with CADC tax provisions linked to the federal credit, except for Massachusetts which applies the federal law in effect on a particular date when the age limit was fifteen. Of the three states with independent CADC tax provisions, one covers expenses for children under thirteen, the other two cover expenses for children under fifteen. Provisions that cover dependents who are incapable of self-care also apply to children above the age limit with this level of incapacity.

**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 adults.

### E. Expense Limits

All state CADC tax provisions, like the federal CADC credit, place an absolute dollar limit on the amount of expenses that can be claimed for the credit or deduction. This reduces the cost of the provision to the government and in a sense is another way of targeting assistance to lower-income families, since only families with higher incomes can afford to incur relatively higher care expenses.

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. Even picking a limit that corresponds to the average cost of care in the state may be too low, because that leaves many taxpayers 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 incorporate its expense limits of $2,400 for one child, spouse, or dependent and $4,800 for two or more of these individuals, less than the average cost of good-quality care.

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48/ These states are Arkansas, Delaware and Maine.
49/ New Mexico and Montana cover expenses for children under age fifteen; Hawaii covers expenses for children under age thirteen.
care—approximately $5,000 a year for a child under age five and even more for an adult dependent. The three states whose CADC tax provisions are independent of the federal credit are not better in this regard; Hawaii has expense limits identical to the federal government; Montana limits expenses 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; and New Mexico limits expenses to $8.00 per day, per child.

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

### F. Coverage for Both In-Home and Out-of-Home Care

Families have different needs and preferences in regard to the use of in-home or out-of-home arrangements to meet their employment-related care needs. As noted above, the federal credit treats these types of care identically (except for rules related to out-of-home care to prevent using the CADC tax provision for institutional care). This equal treatment is incorporated in the provisions of states that link their CADC tax provision to the federal credit. Although historically some of the states with independent provisions have distinguished between in-home and out-of-home care, none of these states currently limits the type of care arrangement eligible for coverage.50

In general, it is best to leave families with as much flexibility as possible in choosing their care arrangement. There is no reason for a state to favor one type of arrangement over another. Both can be of high quality and, given the difficulty families often have finding appropriate care, ruling out one sector of care arrangements can place unwarranted constraints on families.51 If it is felt that differences in the overall cost of one or the other type warrant providing a greater benefit for the more costly care, actual costs should be carefully examined before they are written into the tax provision.

**Best Policy:** State CADC tax provisions should cover both in-home and out-of-home care arrangements without favoring one or the other.

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50/ As previously noted, the Montana statute suggests that only in-home care expenses of adult dependents are eligible for the deduction, while covering both in-home and out-of-home care expenses for children under age fifteen, but the Montana state tax form does not make this distinction.

51/ As previously noted, to impose some quality standards the federal credit requires that expenses paid to a dependent care center meet applicable state and local laws. The effectiveness of this provision depends on the adequacy of the laws and regulations of the state and local area in which the family lives. Of the states with independent CADC provisions, only Hawaii has a similar limitation.
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 was 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. Only one state’s CADC tax provision includes an indexing requirement: Minnesota’s statute requires that the income limitation be adjusted annually for inflation. (In some states, some indexing may also occur because of generally applicable requirements for indexing throughout the state tax code.)

Best Policy: Expense limits, sliding scale thresholds, income maximums, and other similar provisions should be indexed for inflation.

H. Forms

Some states in their tax forms and instructions highlight the availability of the CADC tax provision, making it easier for taxpayers to claim the credit or deduction for which they qualify. Twenty states provide a separate line on the tax form for the CADC provision, alerting even taxpayers who do not carefully read the instructions to its availability. In contrast, the forms of four states have a line for “credits” and refer the taxpayer to a separate schedule on which credits may be claimed, without mentioning until the instructions for the separate schedule that the CADC provision is among these credits. This is problematic, especially for lower-income taxpayers 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. Although it may seem unrealistic to expect a state with many credits or deductions to single out its CADC provision for special attention, many states have done so,

52/ State provisions that are tied to the federal CADC credit will have that credit’s lack of indexing incorporated into their provision. If a state adds additional sliding scale thresholds or income limitations, however, these provisions can be indexed.

53/ These states are Arkansas, Delaware, District of Columbia, Hawaii, Iowa, Idaho, Kentucky, Kansas, Maryland, Massachusetts, Minnesota, Montana, Nebraska, New Mexico, New York, Ohio, Oklahoma, Oregon, South Carolina and Virginia. The Massachusetts form is exceptionally explicit, providing a line for care expenses for a “child under age 15, or disabled dependent/spouse.”

54/ These states are Colorado, Louisiana, Maine and North Carolina.
presumably in recognition of the fact that a large number of taxpayers are eligible for the provision.55

Some states, like the federal government, offer a short form for taxpayers with relatively uncomplicated tax situations.56 Short forms are used primarily by taxpayers with relatively low incomes. Fifteen states with CADC provisions have both long and short forms and eight of these states allow taxpayers to claim the CADC credit or deduction on the short form.57 Two states with CADC provisions allow taxpayers to “telefile” with no form at all; of these, one—Kansas—allows telefilers to claim the CADC tax benefit, while the other—Massachusetts—does not.58 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 taxpayers to understand and claim CADC provisions for which they are eligible. If a state has a short form, taxpayers should be able to claim the CADC provision on that form.

55/ The worst example of a state whose forms and instructions mitigate against taxpayers’ claiming their CADC benefits is Louisiana. As previously noted, Louisiana has a credit for child care and, new for tax year 1997, a separate credit for dependent care. With respect to the child care credit, neither the tax form nor the instructions even mention child care, the child care credit or the federal CADC credit on which it is based. Rather, the taxpayer is instructed on the form to use a separate schedule A for “credits,” and the schedule itself and its instructions simply tell the taxpayer to enter the credit amount from “line 40” of the federal form and apply the applicable state percentage and credit limitations. (In addition, the instructions do not tell the taxpayer to disaggregate any amount on line 40 that is attributable to dependent care expenses, although this omission may not be significant since the maximum child care credit that may be claimed, regardless of the amount of expenses, is only $25.) With respect to the credit for dependent care, the Louisiana forms and instructions are entirely silent. A telephone call to the Louisiana Department of Revenue in March of 1998 yielded the response that this credit “had not yet been added to” the forms and instructions but could also be claimed on schedule A. Since the new dependent care credit is worth as much as $1,440 to the taxpayer (in contrast to the $25 maximum of the Louisiana child care credit), and dependent care credit amounts not used in a particular tax year can be carried forward to the next succeeding tax year (but only that year), the absence of any mention of the new credit on the 1997 forms or instructions is especially egregious.

56/ The federal government has a long, short and EZ tax form. Taxpayers may use the long or short form to claim the federal CADC. However, since the EZ form may only be used by taxpayers not claiming children or other dependents, it may not be used to claim the federal CADC. For purposes of this discussion, only state EZ forms that may be used by taxpayers claiming children or other dependents are considered short forms.

57/ These states are Arkansas, Hawaii, New Mexico, New York, North Carolina, Oklahoma, Oregon, and South Carolina. The states that have short forms but only allow taxpayers to claim the CADC credit or deduction on the long form are Colorado, Iowa, Kentucky, Maine, Maryland, Montana and Virginia.

58/ Minnesota currently has a pilot program to test telefiling with selected taxpayers.
I. Filing Requirements for Married Couples

The federal government and some states, including the District of Columbia, Hawaii, and South Carolina, require that a married couple file a joint return to be eligible for the CADC tax credit or deduction. Some states have rules for married couples filing separate returns to prevent the family from receiving the tax benefit twice. However, some states’ requirements as to how the CADC tax provision is to be split between the spouses when they file separately may 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, 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 New Mexico and Montana—whose provisions require the spouses to split the benefit evenly—and by Iowa—whose provision requires the spouses to divide the benefit according to the ratio of their respective incomes to their combined income. The best approach is Virginia’s, which allows spouses to divide the deduction in the way that maximizes their CADC tax benefit, so long as they receive the deduction 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.

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

J. Residency

Nine states limit their CADC provision to residents—Colorado, Delaware, Hawaii, Kansas, Kentucky, Nebraska, New Mexico, North Carolina, and Oklahoma—with many of these states allowing part-year residents to apportion the amount of 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 that state by taxes paid in another state. Thirteen states allow nonresidents to claim the CADC credit or deduction—Arkansas, Idaho, Iowa, Louisiana, Maine, Maryland, Massachusetts, Minnesota, Montana, New York, Ohio, Oregon, and Virginia—with many of these states providing for

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59/ The District of Columbia limits its income tax to nonresidents.
60/ In Oklahoma, the credit is available to nonresident members of the Armed Forces.
61/ 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.
some apportionment of the amount of the credit based on income earned in the state. South Carolina allows nonresidents to claim its credit if they are residents of a state that would allow South Carolinians to take a CADC credit or deduction. 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, although states may want to prorate benefits for nonresidents.

### V. Conclusion

Carefully drafted state child and dependent care tax provisions can help many families with large 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.
### VI. Appendix

### STATE CHILD AND DEPENDENT CARE TAX CREDITS: TAX YEAR 1997

<table>
<thead>
<tr>
<th>State</th>
<th>Basic Provision</th>
<th>Eligible Expenses</th>
<th>Refundable</th>
<th>Maximum: One Dependent</th>
<th>Maximum: Two or More Dependents</th>
</tr>
</thead>
<tbody>
<tr>
<td>AR</td>
<td>A <em>credit</em> of 10% of the “allowable” federal CADC credit, or of 20% if expenses are for developmentally appropriate early childhood education program for child 3 to 5 years old.</td>
<td>Expenses eligible for the federal CADC credit.</td>
<td>Partially: credit for expenses for early childhood education program only</td>
<td>$144</td>
<td>$288</td>
</tr>
</tbody>
</table>
| 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  
- 30% if federal AGI is between $25,001 and $35,000  
- 10% if federal AGI is between $35,001 and $60,000.  
- No credit is allowed if federal AGI exceeds $60,000. | Child care expenses eligible for the federal CADC credit. | No | $360 | $720 |
| DE    | A *credit* of 50% of the “allowable” federal CADC credit. | Expenses eligible for the federal CADC credit. | No | $360 | $720 |
| DC    | A *credit* of 32% of the “allowable” federal CADC credit. | Expenses eligible for the federal CADC credit. | No | $230 | $461 |
| 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 Hawaii AGI exceeds $22,000 but is no more than $40,000.  
- 15% if Hawaii AGI exceeds $40,000. | Expenses currently eligible for federal CADC credit. | Yes | $600 | $1,200 |

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1/ The federal CADC credit covers 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.  
Expenses are capped at a maximum of $2,400 for one child, spouse, or dependent, and $4,800 for two or more of these individuals.  

2/ AGI is adjusted gross income.  

3/ However, if Colorado’s CADC 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.  

4/ The District of Columbia statute specifically says that the taxpayer is entitled to a credit of 32% of the federal credit allowed, “regardless of the amount of the credit that is actually used to offset federal tax liability.”  

5/ Hawaii’s provision is independent of the federal credit. For tax year 1997, the eligible expenses are identical to those eligible for the federal credit, and, for that reason, are not set forth separately here.
<table>
<thead>
<tr>
<th>State</th>
<th>Basic Provision</th>
<th>Eligible Expenses</th>
<th>Refundable</th>
<th>Maximum: One Dependent</th>
<th>Maximum: Two or More Dependents</th>
</tr>
</thead>
<tbody>
<tr>
<td>ID</td>
<td>A deduction of expenses eligible for the federal credit.</td>
<td>Expenses eligible for the federal CADC credit.</td>
<td>No</td>
<td>$197</td>
<td>$394</td>
</tr>
<tr>
<td>IA</td>
<td>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 between $10,000 and $19,999 - 55% if Iowa net income is between $20,000 and $24,999 - 50% if Iowa net income is between $25,000 and $34,999 - 40% if Iowa net income is between $35,000 and $39,999. No credit is allowed if Iowa net income is $40,000 or more.</td>
<td>Expenses eligible for the federal CADC credit.</td>
<td>Yes</td>
<td>$540</td>
<td>$1,080</td>
</tr>
<tr>
<td>KS</td>
<td>A credit of 25% of the federal CADC credit “allowed against the taxpayer’s federal income tax liability.”</td>
<td>Expenses eligible for the federal CADC credit.</td>
<td>No</td>
<td>$180</td>
<td>$360</td>
</tr>
<tr>
<td>KY</td>
<td>A credit of 20% of the “allowed” federal CADC credit.</td>
<td>Expenses eligible for the federal CADC credit.</td>
<td>No</td>
<td>$144</td>
<td>$288</td>
</tr>
<tr>
<td>LA</td>
<td>A credit for “child care” equal to 10% “of the same credit allowed on the federal income tax return,” but no greater than $25; a credit for “dependents physically or mentally incapable of self-care” of 100% of the federal CADC credit.</td>
<td>Expenses eligible for the federal CADC credit.</td>
<td>No</td>
<td>$25 for child care; $720 for dependent care</td>
<td>$25 for child care; $1,440 for dependent care</td>
</tr>
<tr>
<td>ME</td>
<td>A credit of 25% of the “allowable” federal CADC credit.</td>
<td>Expenses eligible for the federal CADC credit.</td>
<td>No</td>
<td>$180</td>
<td>$360</td>
</tr>
<tr>
<td>MD</td>
<td>A deduction of expenses up to the dollar amount of expenses allowed under the federal credit.</td>
<td>Expenses eligible for the federal CADC credit.</td>
<td>No</td>
<td>$120</td>
<td>$240</td>
</tr>
</tbody>
</table>

6/ Idaho’s top tax rate is 8.2%.

7/ However, if Louisiana’s dependent care credit exceeds the income tax due, the unused amount of the credit may be carried forward as a credit against tax liability in the next succeeding tax year.

8/ Maryland’s top tax rate is 5 percent.
### State Basic Provision Eligible Expenses Refundable Maximum: One Dependent Maximum: Two or More Dependents

<table>
<thead>
<tr>
<th>State</th>
<th>Basic Provision</th>
<th>Eligible Expenses</th>
<th>Refundable</th>
<th>Maximum: One Dependent</th>
<th>Maximum: Two or More Dependents</th>
</tr>
</thead>
<tbody>
<tr>
<td>MA</td>
<td>A deduction9 of expenses up to $2,400 for one child or dependent, $4,800 for two or more.</td>
<td>Expenses eligible for the federal CADC credit as in effect on January 1, 198810.</td>
<td>No</td>
<td>$143</td>
<td>$286</td>
</tr>
<tr>
<td>MN</td>
<td>A credit, for taxpayers with incomes no greater than $16,960, of “an amount equal to” the federal CADC credit for which the taxpayer is “eligible”,11 up to a maximum of $720 for one child or dependent and a maximum of $1,440 for two or more. For taxpayers with incomes over $16,960, the maximum credit is reduced by $18 for every additional $350 of income if one child or dependent, and $36 for every additional $350 of income if two or more children or dependents. No credit is allowed if income is over $30,610. The income limitation is indexed for inflation.</td>
<td>Expenses eligible for the federal CADC credit.</td>
<td>Yes</td>
<td>$720</td>
<td>$1,440</td>
</tr>
<tr>
<td>MT</td>
<td>A deduction of eligible expenses. For taxpayers with AGIs over $18,000, deductible expenses are reduced by one half of the amount of income over $18,000. No deduction is allowed if AGI is $22,800 or more if one child, spouse or dependent; $25,200 if two of these individuals; $27,600 if three or more of these individuals.</td>
<td>Expenses 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.12 Expenses are capped at a maximum of $2,400 for one child, spouse, or dependent, $3,600 for two, and $4,800 for three or more.</td>
<td>No</td>
<td>$168</td>
<td>$252 for two, $336 for three or more13</td>
</tr>
</tbody>
</table>

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9/ Massachusetts' tax rate, applicable to all income levels, is 5.95%

10/ The federal credit in effect on January 1, 1988, includes expenses for children age 13 and 14, as well as all other expenses currently covered by the federal credit.

11/ The Minnesota statute states that even taxpayers who are not required and do not file a federal tax return may claim a Minnesota credit based on the federal credit for which they would have been eligible.

12/ The Montana statute seems to suggest that only expenses for in-home care of dependents are eligible for the deduction, while covering both in-home and out-of-home care expenses for children under age 15. However, the Montana tax form does not make this distinction.

13/ Montana's tax rate is 7% for taxpayers with Montana AGI of $18,000—the highest AGI level at which a taxpayer can take the full Montana deduction.
<table>
<thead>
<tr>
<th>State</th>
<th>Basic Provision</th>
<th>Eligible Expenses</th>
<th>Refundable</th>
<th>Maximum: One Dependent</th>
<th>Maximum: Two or More Dependents</th>
</tr>
</thead>
<tbody>
<tr>
<td>NE</td>
<td>A credit of 25% of the “allowed” federal CADC credit.</td>
<td>Expenses eligible for the federal CADC credit.</td>
<td>No</td>
<td>$180</td>
<td>$360</td>
</tr>
<tr>
<td>NM</td>
<td>A credit of 40% of eligible expenses, reduced, for taxpayers with federal tax liability, by the amount of the taxpayer’s federal credit used to offset federal tax liability. 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 $20,317.14</td>
<td>Expenses for in-home and out-of-home care for children under age 15. Expenses are capped at a maximum of $8 per day, per child.</td>
<td>Yes</td>
<td>$480</td>
<td>$960 for two, $1,200 for three or more</td>
</tr>
<tr>
<td>NY</td>
<td>A credit of a specified percentage of the “allowable” federal CADC credit as follows: - 60% if NY AGI is $10,000 or less - Between 59.5% and 20.5% if NY AGI is between $10,001 and $13,999 - 20% if NY AGI is $14,000 or more.</td>
<td>Expenses eligible for the federal CADC credit.</td>
<td>Yes&lt;sup&gt;3&lt;/sup&gt;</td>
<td>$432</td>
<td>$864</td>
</tr>
<tr>
<td>NC</td>
<td>A credit of a specified percentage of “allowed” federal CADC expenses as follows: - For children under age 7 and other qualifying dependents incapable of self-care: • 13% if federal AGI is between 0 and $25,000, depending on the filing status of the taxpayer • 11.5% if federal AGI is between $12,501 and $40,000, depending on the filing status of the taxpayer • 10% if federal AGI ranges from $20,000 to $40,000 and over, depending on the filing status of the taxpayer - For children age 7 and over: • 9% if federal AGI is between 0 and $25,000, depending on the filing status of the taxpayer • 8% if federal AGI is between $12,501 and $40,000, depending on the filing status of the taxpayer • 7% if federal AGI ranges from $20,000 to $40,000 and over, depending on the filing status of the taxpayer.</td>
<td>Expenses eligible for the federal CADC credit</td>
<td>No</td>
<td>$312</td>
<td>$624</td>
</tr>
<tr>
<td>State</td>
<td>Basic Provision</td>
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</table>
| OH    | A *credit* of a specified percentage of the federal credit for which the taxpayer is *eligible* as follows:  

- 100% if Ohio AGI is less than $20,000  
- 25% if Ohio AGI is between $20,000 and $39,999.  
No credit is allowed if Ohio AGI is equal to or more than $40,000. | Expenses eligible for the federal CADC credit. | No | $720 | $1,440 |
| 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. | No | $144 | $288 |
| OR    | A *credit* of a specified percentage of expenses allowable for the federal credit as follows:  

- 30% if federal taxable income is less than $5,001  
- 15% if federal taxable income is between $5,001 and $10,000  
- 8% if federal taxable income is between $10,001 and $15,000  
- 6% if federal taxable income is between $15,001 and $25,000  
- 5% if federal taxable income is between $25,001 and $35,000  
- 4% if federal taxable income is between $35,001 and $45,000.  
No credit is allowed if federal taxable income exceeds $45,000. | Expenses eligible for the federal CADC credit. | No | $720 | $1,440 |

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14/ 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.”

15/ 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.

16/ The Ohio statute specifically says that the credit is based on the amount of the federal credit for which the taxpayer is eligible, “without regard to any limitations imposed by” the federal credit’s nonrefundability provision.

17/ It is unclear from the Oklahoma statute and forms whether care expenses other than for children are eligible for the credit.

18/ Federal taxable income is federal adjusted gross income less federal exemptions and deductions.

19/ However, if Oregon’s CADC exceeds the income taxes 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.
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<tr>
<td>SC</td>
<td>A <em>credit of 7%</em> of federal CADC expenses.</td>
<td>Expenses eligible for the federal CADC credit.</td>
<td>No</td>
<td>$168</td>
<td>$336</td>
</tr>
<tr>
<td>VA</td>
<td>A <em>deduction</em> of expenses on which the federal CADC credit is based.</td>
<td>Expenses eligible for the federal CADC credit.</td>
<td>No</td>
<td>$138</td>
<td>$276</td>
</tr>
</tbody>
</table>

20/ Virginia’s top tax rate is 5.75%
## State Child and Dependent Care Tax Provisions: Tax Year 1997

<table>
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<tr>
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<tbody>
<tr>
<td>Iowa</td>
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</tr>
<tr>
<td>Minnesota</td>
<td>Minn. Stat §290.067 (1997)</td>
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</table>