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CHILD CARE & EARLY LEARNING CHILD CARE DEDUCTIONS FAVOR HIGH INCOME FAMILIES

High-quality child care gives children a strong start toward success in school and life and enables parents to work and support their families. Yet many families—particularly lowincome families—lack access to the high-quality child care and early education they need.

There are different ways the tax code can provide families a benefit to help offset some of the costs of child care—credits and deductions. A tax deduction reduces a filer's taxable income, while a credit reduces the amount of taxes a filer owes. However, as currently structured, families only receive tax assistance once a year, when they file their taxes, although they must pay child care expenses throughout the year.

In contrast, direct child care assistance through the federally and state funded Child Care and Development Block Grant goes directly to families or providers continuously throughout the year, as child care expenses are incurred.

Current child care tax provisions are not structured to help low-income families who need them the most. Although the two current tax provisions—the Child and Dependent Care Tax Credit (CDCTC) and the Dependent Care Flexible Spending Account (FSA)—are intended to help working families meet their child care expenses, in practice, these provisions provide little or no help to low-income families. Proposals to make child care expenses entirely tax deductible would help lowincome families even less, while directing the vast majority of the benefits to higher income families. All families need access to high-quality child care. Child care deductions, however, favor high-income families while direct subsidies and refundable tax credits can better meet the needs of families who need it the most.

Access to high-quality child care is integral to the economic security of women and families, but child care is expensive.

- Child care consumes a larger share of the budgets of lowerincome families. Families below the federal poverty line who pay for child care for children under age five spend an average of 36 percent of their incomes on that care.¹ Families with incomes between 100 to 200 percent of the federal poverty line who pay for child care for children under age five spend an average of 20 percent.²
- One in five working mothers of very young children works in jobs that typically pay \$10.50 per hour or less.³ A woman who earns \$10.50 per hour and works full time only makes \$21,000 per year.
- The average cost of full-time care for one child ranges from approximately \$3,700 to over \$17,000 a year, depending on the age of the child, the type of care, and where the family lives.⁴

Making child care payments tax deductible would benefit high-income families, while providing little help to low-income families.

• Under the tax code, if tax filers elect to file a tax return with itemized deductions, certain kinds of expenses can be deducted from income before taxes are calculated. By reducing taxable income, the tax filers will lower the amount of taxes that are owed. Home mortgage interest, certain medical expenses, and charitable contributions are examples of expenses that can be deducted from income under current law.





- A tax deduction for child care payments would favor higher-income families.
 - Many lower-income families would not be able to receive any benefit from a deduction at all. If a family does not earn enough to incur income tax liability, it will receive no benefit from a tax deduction. This means that the millions of households with incomes too low to incur federal income tax liability would receive no benefit from a tax deduction.⁵
 - In addition, lower-income families are less likely to file their taxes with itemized deductions, as they would need to do to benefit from a tax deduction related to child care expenses. In order to claim most tax deductions other than the standard deduction, a filer has to itemize deductions on their tax return—something only about 30 percent of all tax filers choose to do overall. In addition, higher income households are much more likely to itemize, whereas low-and middle-income households are more likely to claim the standard deduction. Among tax filers with AGI above \$200,000, over 90 percent itemize. In contrast, only 6 percent of filers with AGI below \$20,000 and only 22 percent of filers with AGI between \$20,000 and \$50,000 itemize.⁶ That means that 80 percent of tax filers with AGI between \$20,000 and \$50,000 would not benefit from a child care expense tax deduction.
 - Tax deductions are also worth more for households in higher tax brackets. For example, a \$1,000 deduction reduces the tax owed by a family in the highest tax bracket by \$350 because their income is taxed at 35 percent. For a family in the 15 percent tax bracket, a \$1,000 deduction reduces their tax owed by only \$150.

Low-income families also receive little help from Dependent Care Flexible Spending Accounts.

• Under current law, employers can (but are not required to) offer Dependent Care Flexible Spending Accounts (FSAs) to their employees. Employees whose employers offer Dependent Care FSAs can elect to set aside and exclude from income up to \$5,000 of pre-tax income for workrelated child and dependent care expenses. The income set aside to pay for these expenses is not subject to payroll or income taxes. However, if the employee does not use that income for child or dependent care expenses during a particular tax year, the FSA funds are forfeited.

- Estimates from the U.S. Department of the Treasury show that low- and moderate-income families will receive only a small share of the tax benefits of Dependent Care FSAs. Families with AGI below \$75,000 will receive just 10 percent of the tax benefits, while families with incomes above \$200,000 will receive 38 percent of the tax benefits, for tax year 2016.⁷
- There are several reasons why low-income families receive so few benefits from Dependent Care FSAs:
 - The income tax benefit from an exclusion of income is greater for people in higher tax brackets. A family in the 35 percent tax bracket that sets aside \$5,000 in an FSA receives a \$1,750 income tax break, more than three times as much as a family in the 10 percent bracket (\$500).
 - Low-wage workers are far less likely to have access to a Dependent Care FSA at work. Only 16 percent of private industry workers earning wages in the bottom 25th percentile had access to dependent care reimbursement accounts in 2014. In contrast, 61 percent of private industry workers whose wages were in the top 25th percentile had access to these FSAs through their employer.⁸
 - Low-wage workers with unstable and unpredictable earnings and child care needs may be reluctant to set aside part of their paycheck into a "use it or lose it" account.

In contrast to deductions, direct assistance and refundable tax credits can better meet the needs of families who need it the most.

Direct assistance through subsidies would help lowincome families with the cost of child care.

- Expanding investments in direct child care assistance would enable more low- and moderate-income parents to access affordable, high-quality care for their children and allow child care providers to earn wages that are sufficient to support themselves and their own families.
- As opposed to tax credits or a tax deduction which only provide benefits in a single payment at tax time, direct child care assistance through subsidies can be made available on a weekly, bi-weekly, or monthly basis which enables parents to budget and pay for their child care bills throughout the year.





Making the federal Child and Dependent Care Tax Credit refundable would benefit low-income families.

- The federal CDCTC allows parents to claim a tax credit for part of their work-related child or dependent care expenses. The credit is equal to between 20 and 35 percent of allowable expenses: up to \$3,000 for one child or dependent and up to \$6,000 for two or more children or dependents. Families with an Adjusted Gross Income (AGI) of \$15,000 or less can claim 35 percent of allowable expenses. The percentage of allowable expenses that can be claimed declines as family income rises, to 20 percent for families with AGI above \$43,000.
- On paper, the lowest-income families are eligible for the largest credit. The credit can be worth up to \$2,100 for a family with AGI of \$15,000 or less (35 percent of \$6,000) compared to a maximum of \$1,200 for a family with AGI above \$43,000 (20 percent of \$6,000). However, because the CDCTC is not refundable—it can only be used to offset federal income tax liability-many low-income families receive little or no benefit from the credit because they have little or no federal income tax liability.

- o A single mother with two children must have an AGI above \$21,250 to have any federal income tax liability, assuming she claims the standard deduction and appropriate personal exemptions. With an AGI below \$21,250 she would not qualify for any benefit from the credit.
- As currently structured, the CDCTC disproportionately benefits higher-income families: Estimates from the U.S. Department of the Treasury show that, for example, families making less than \$30,000 will receive only 8 percent of the tax benefits from the CDCTC while families making over \$100,000 will receive 38 percent of the benefits from this credit.9
- Improving the CDCTC, including by making it refundable, has the potential to benefit low-income families, including over a million families who would receive tax benefits from the credit for the first time.¹⁰
- 1 U.S. Census Bureau, Who's Minding the Kids? Child Care Arrangements: 2011, Detailed Tables, Table 6: Average Weekly Child Care Expenditures of Families with Employed Mothers that Make Payments, by Age Groups and Selected Characteristics: Spring 2011 (2013). 2 Id.
- 3 The "low-wage workforce" is defined here as \$10.50 or less per hour. Median hourly wages for occupations are determined using the Bureau of Labor Statistics (BLS) Occupational Employment Statistics data from May 2014 (http://www.bls.gov/oes/current/oes_nat.htm). Data are National Women's Law Center calculations based on Current Population Survey (CPS) 2014 using Miriam King et al., Integrated Public Use Microdata Series (IPUMS), Current Population Survey: Version 3.0 [Machine-readable database] (Minneapolis: University of Minnesota, 2010).
- 4 Child Care Aware of America, Parents and the High Cost of Child Care: 2015 Report (Arlington, VA: Child Care Aware of America, 2015), 30, available at http://usa.childcareaware.org/wp-content/uploads/2015/12/Parents-and-the-High-Cost-of-Child-Care-2015-FINAL.pdf.
- 5 Catey Hill, MarketWatch, 45% of Americans Pay No Federal Income Tax (Apr. 18, 2016 1:58 PM), available at http://www.marketwatch.com/story/45-of-americans-pay-no-federal-income-tax-2016-02-24.
- 6 Sean Lowry, Congressional Research Service, Itemized Tax Deductions for Individuals: Data Analysis 3 (Feb. 12, 2014), available at https://www.fas.org/sgp/crs/misc/R43012.pdf.
- 7 U.S. Department of Treasury, Office of Tax Analysis, Child Care Tax Benefits in 2016, Table 2: Families Benefiting and Amount of Benefit from the Exclusion of Dependent Care Benefits: Tax Year 2016, available at
- http://www.treasury.gov/resource-center/tax-policy/Documents/OTAR-Child-Care-Tax-Benefits-in-2016.pdf.
- 8 Eli R. Stoltzfus, Access to dependent care reimbursement accounts and workplace-funded childcare, Bureau of Labor Statistics (January 2015), http://www.bls.gov/opub/btn/volume-4/access-to-dependent-care-reimbursement-accounts-and-workplace-funded-childcare.htm.
- 9 U.S. Department of Treasury, Office of Tax Analysis, Child Care Tax Benefits in 2016, Table 3: Families Benefiting and Amount of Benefit from the Child and Dependent Care Tax Credit: Tax Year 2016, available at http://www.treasury.gov/resource-center/tax-policy/Documents/OTAR-Child-Care-Tax-Benefits-in-2016.pdf.
- 10 Tax Policy Center, Urban Institute & Brookings Institution, T13-0195: Expansion of Child and Dependent Care Tax Credit Returns and Amount Reported Compared to Current Law, 2014, available at

http://www.taxpolicycenter.org/model-estimates/expand-child-and-dependent-care-tax-credit/expansion-child-and-dependent-care-tax-3.

