Making Care Less Taxing: State Child and Dependent Care Tax Provisions

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NATIONAL WOMEN'S LAW CENTER

ABOUT THE CENTER

We're passionate champions of policies and laws that help women and girls achieve their potential throughout their lives — at school, at work, at home, and in their communities. We're committed advocates who take on the toughest challenges, especially for the most vulnerable women — and we make change happen. We're proud to have been on the frontlines of virtually every advance for women for more than 40 years, benefitting their families, their communities, and the nation.

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NATIONAL WOMEN'S LAW CENTER
EXPANDING THE POSSIBILITIES

COLORADO CHILDREN'S CAMPAIGN
Every Chance for Every Child

Agenda

- Background: what are child and dependent care tax provisions and how do they help families?
- Models for tax provisions:
  - Limitations
  - "Gold Standards"
- State Perspective: Colorado

Child and Dependent Care Tax Benefits

- For families:
  - *Federal Child and Dependent Care Tax Credit*
  - *27 states and the District of Columbia* have child care tax provisions
    - 23 states and D.C. have *credits* (12 refundable)
    - 5 states have *deductions*
  - *Federal Dependent Care Assistance Plans*
- For employers
- For child care providers and teachers/staff

Why have a child and dependent care tax provision?

- Families across the country struggle with the high cost of child care
- But direct assistance is not available for all families who need help
- Child and dependent care tax provisions *reduce the amount of tax or provide tax refunds*

What is a child and dependent care tax provision?

Families who pay out-of-pocket, work-related expenses for child and dependent care can claim a portion of those expenses as a tax benefit when they file their tax returns the following year.

Let's break this down.

Out-of-pocket, work-related care expenses…

- **Care** has to allow adults in the family to work (or, if married, for one of the couple to attend school full-time)
- **Child care:** care for children under age 13
  - *Examples:* care provided in the family's home or the home of a neighbor or relative, a child care center, family day care home, preschool, before- or after-school care, and even summer or school vacation day camps
- **Dependent care:** care for a spouse, child age 13 or over, or other family member who lives in the same household, who is physically or mentally incapable of self-care
  - *Example:* adult day care
  - *But not:* residential living facilities or nursing homes
- Families have to pay child and dependent care costs in order to use them to claim tax benefits (including co-pays)

Calculating the tax benefit

- Families can generally claim eligible care expenses up to a certain dollar limit for child and dependent care tax benefits
- Expense limits in many states: $3,000 for 1 child/dependent, $6,000 for 2 or more children/dependents
- A percentage of those expenses, generally based on income, is applied to the amount of eligible expenses to calculate the amount of the tax benefit

Applying the tax benefit

- A **tax credit** lowers the amount of taxes a family owes by a set amount
  - **Refundable credits** lower the amount of taxes a family owes by a set amount and provide a payment (refund) if the credit amount exceeds the family's tax liability
  - **Non-refundable credits** lower a family's tax liability by a set amount but do not provide a refund; the amount of the credit cannot exceed the family's tax liability
- A **tax deduction** reduces a family's taxable income, which lowers the family's tax liability
  - The value depends on the family's tax rate, so tax deductions are worth *less for families with lower income* and worth *more for families with higher income*

Example

- Cristina and John live in Silver Spring. MD. They have 2 kids and will pay $6,000 in child care expenses in 2018. They will earn $24,000 in 2018.
  - *Theoretically* maximum federal credit of $1,800 (nonrefundable) and a MD child care credit of $585 (nonrefundable).
  - *In actuality*, if they claimed the standard deduction on their federal return and received the child tax credit, they might not receive any federal credit (and thus no MD credit).

Claiming the tax provision

- Families usually file their taxes in the following year (ex: tax returns for 2018 are filed in 2019)
- So families claiming child and dependent care tax provisions in April 2019 base their claim on expenses that they already paid in 2018

Popular Models

- Based on the federal credit
- Based on expenses
- Refundability
- Sliding scales based on income (or income caps)
- Quality Credits

Limitations

- Advancing a tax strategy without advocating for direct child care assistance
- Non-refundable credits or deductions
- Low expense limits
- Calculating the state credit based on the federal credit received
- Not indexing the credit amounts and parameters for inflation

Let's break down those limitations.

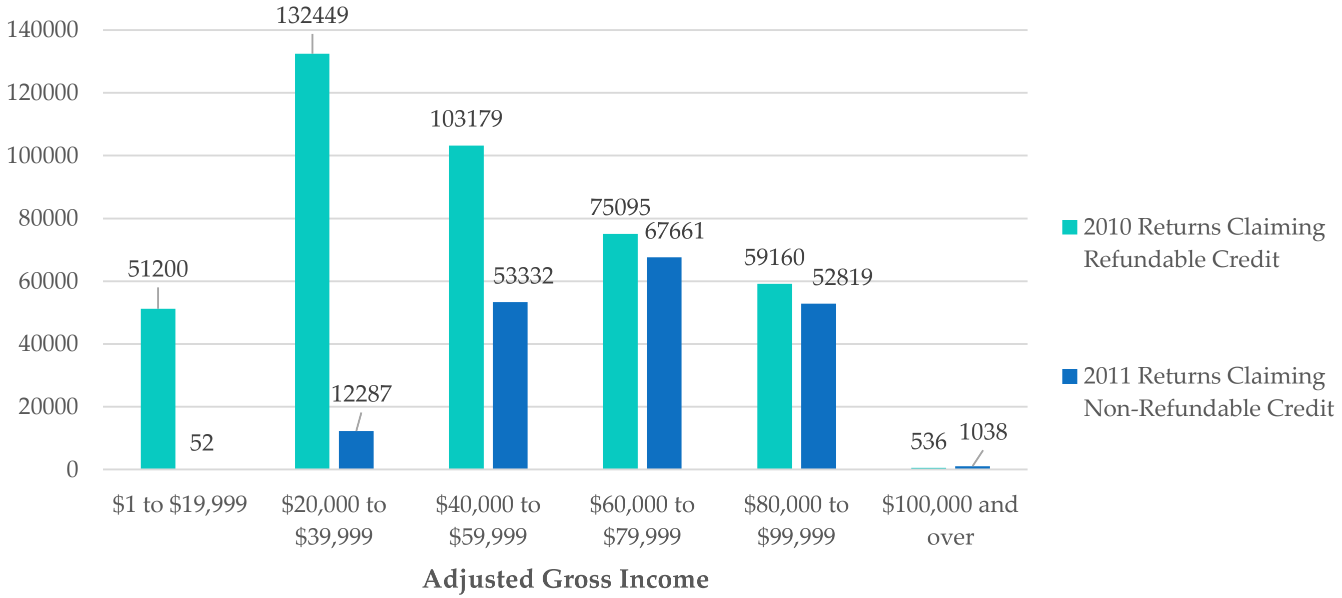
Timing of Tax and Direct Child Care Assistance

- Tax relief only comes *once a year*
- Direct child care assistance provides financial assistance to families throughout the year, *as they incur their child care expenses*, rather than having to wait for the annual tax time

Non-Refundable Credits or Deductions

- Less valuable for low-income families
- Many low-income families do not have enough tax liability to claim non-refundable credits or deductions

Example:



Source: NWLC Calculations based on State of California Franchise Tax Board Data

Expense Limits

- In 2017, average annual child care costs ranged from *nearly $3,000 to over $23,000* depending on the type of care arrangement, the age of the child, and location
- In 2017, the median annual cost for full-day, adult dependent care services was *$18,720*

Calculating the state credit based on the federal credit received

- Using this approach takes the family's federal tax liability into account
- This means that the state credit will be less valuable for low-income families (like Cristina and John)
  - Income: $24,000
  - Child Care expenses: $6,000 for 2 kids
  - *Theoretically* maximum federal credit of $1,800 (nonrefundable) and a MD child care credit of $585 (nonrefundable)
  - *In actuality*, they may not have any federal tax liability to receive either the federal or MD credit

Failure to Index

- Not indexing the credit amounts and parameters for inflation makes the credit less valuable over time

Gold Standards

- ✓ *Paired* with robust direct child care assistance
- ✓ Refundable credit
- ✓ Generous expense limits
- ✓ More generous for lower-income families
- ✓ If based on the federal credit, provides a *workaround for nonrefundability*
- ✓ Indexing for inflation

Example

Iowa

- ✓ **Refundable credit**
- ✓ **More generous for lower-income families:** uses a sliding scale with maximum percentage: 75% @ $10,000 or less
- ✓ **If based on the federal credit, provides a *workaround for nonrefundability*:** percentage is based on the federal credit *before* it is reduced by tax liability

- **Maximum value:** $1,575 (for 2 or more children/dependents)
- **Average credit:** $284.61

Example

Oregon

- ✓ **Refundable credit**
- ✓ **Generous expense limits:** $12,000 for 1 child/dependent, $24,000 for 2 or more children/ dependents
- ✓ **More generous for lower-income families:** uses a sliding scale based on income (in addition to household size and age of children)

- **Maximum value:** $18,000 (for 2 or more children/dependents)
- **Average credit:** $1,092

Example

Colorado

- ✓ ***Paired* with direct child care assistance advocacy**
- ✓ **Refundable credits:** Child Care Expense Tax Credit and Low-Income Child Care Expenses Credit
- ✓ **More generous for lower-income families:** Child Care Expense Tax Credit is based on the federal credit received with a sliding scale: maximum percentage is 50% @ $25,000 or less
- ✓ **If based on the federal credit, provides a *workaround for nonrefundability***
  - ✓ Created a Low-Income Child Care Expenses Credit for families with incomes of $25,000 or less who did not have sufficient tax liability to claim the federal credit
  - ✓ The credit is worth 25% of child care expenses

<u>Child Care Expense Tax Credit</u>

- **Maximum value:** $1,050 (for 2 or more children/dependents)
- **Average credit (2015):** $152.57

<u>Low-Income Child Care Expenses Credit</u>

- **Maximum value:** $1,000 (for 2 or more children/dependents)
- **Average credit (2015):** $153.18

State Perspective: Colorado

- **The Colorado Child Care Strategy Since 2013: Direct Investment & Tax Credits**

- **Lessons Learned**
  - Clarity on what problem we are solving
  - Refundability & the Federal credit
  - The Politics of Tax Credits

Resources for You

- Upcoming *Making Care Less Taxing* report
- Technical Assistance
- Advocacy Assistance

Questions?

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