NATIONAL WOMEN'S LAW CENTER
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FACT SHEET | APRIL 2021

CHILDCARE AND EARLY LEARNING

THE CHILD AND DEPENDENT CARE TAX CREDIT HELPS WORKING FAMILIES WITH THE HIGH COST OF CHILD CARE

Child care is fundamental to the economic security of women and families, and to an equitable economic recovery.

The pandemic has made it even more difficult for parents to afford and access the high-quality, reliable child care they need to work. Many parents, especially mothers, have been pushed out of the workforce.[1] These job and income losses have been devastating not only for women and their families, but also for the economy as a whole. Access to affordable, high-quality to child care is essential to ensuring that women can return to the workforce and rebuild financial security for themselves and their families.

- ***Child care was unaffordable for parents even before the pandemic.*** In 2018, the average national cost of care for one child was $9,100–$9,600, though prices vary widely between states.[2] The average couple with children would need to spend more than 10 percent of their household income to cover this average cost—well above the Department of Health and Human Services' recommendation that child care costs constitute no more than 7 percent of household income.[3] This burden is even higher for low-income families, who spend more than a third of their income on care.[4]

- ***Even before the pandemic, decades of underfunding left the child care system fragmented and difficult to access***.[5] Child care providers operate on razor-thin profit margins and rely on an underpaid and undervalued child care workforce, the majority of whom are women and disproportionately women of color.[6] The Child Care and Development Block Grant (CCDBG) is the main federal program that provides funding to states to help families afford child care, improve the safety and quality of child care, and support the child care workforce—but underfunding means that six out of seven children eligible do not receive assistance at all.[7]

- ***The pandemic has highlighted the critical importance of child care to women, families, and the economy as a whole.*** The already underfunded child care industry has been devastated by the pandemic. The industry has lost one in six child care jobs since the start of the pandemic, and many child care providers are on the edge of shutting down.[8] The near-collapse of the industry has made it even harder for families to access reliable care and for women to remain in the workforce. Since the outset of the crisis, women have lost a net five million jobs and 2.3 million women have left the workforce entirely,[9] with child care obligations likely playing a large role. In August 2020, almost a third of women ages 25-44 who were not working cited child care demands as the reason (compared to only about 12 percent of men in the same age group).[10] As families across the nation struggle to pay their bills and keep food on the table,[11] it is clearer than ever that child care is essential to ensuring the financial security of women and their families.

- ***Significant public investments are required to sustain the child care sector during COVID and to ensure a robust recovery and an equitable economy in the future***. The American Rescue Plan Act of 2021 (ARPA) has funded a child care stabilization fund to support child care providers through COVID. The ARPA also provided an influx of direct funding to the CCDBG and permanent increases to the Child Care Entitlement to States,[12] along with temporary expansions to the Child and Dependent Care Tax Credit. But we need long-term, structural changes to build back a better system and to adequately value and support the 21st-century caregiving and early education workforce the country needs.[13]

The Child and Dependent Care Tax Credit provides tax assistance to parents who pay out-of-pocket child or dependent care expenses in order to work.

The federal Child and Dependent Care Tax Credit (CDCTC) helps families meet their out-of-pocket, work-related child and dependent care expenses. The CDCTC is distinct from the Earned Income Tax Credit (EITC), which helps offset the payroll taxes of low- and moderate-income workers, and the Child Tax Credit (CTC), which helps families with the cost of raising children more generally.[14] The CDCTC is the only federal tax credit that specifically addresses the additional care expenses that parents incur when they work, look for work, or (in some cases) go to school.

The CDCTC allows families to claim a percentage of their work-related child and dependent care expenses, up to a specific limit. For tax year 2020, the expense limits were $3,000 for one child or dependent, and $6,000 for two or more children or dependents. The credit covers expenses for child or dependent care that allows the parent (or parents if filing jointly) to work or look for work. Such expenses may include the cost of an in-home babysitter or nanny, family, friend, or neighbor (FFN) care, home-based child care, child care centers, as well as before- or after-school care.[15]

The credit is calculated as a percentage of expenses. The percentage of eligible expenses that a family may claim is based on a sliding scale that declines with income. For tax year 2020, the percentage ranges from 35 percent (for families with Adjusted Gross Income or AGI, of $15,000 or less) to 20 percent (for families with AGI of $43,000 and above).[16]

For tax year 2020, the CDCTC was nonrefundable, and theoretically worth a maximum of $2,100, for a family with AGI under $15,000 who had spent $6,000 on child or dependent care. In reality, because the credit is not refundable, most low-income families generally received little or no benefit from it. Indeed, a 2018 analysis from the Tax Policy Center showed that only 1 percent of the benefits from the CDCTC went to families with AGI of $30,000 or less.[17]

Illustrative Example of How the CDCTC Works for Tax Year 2020

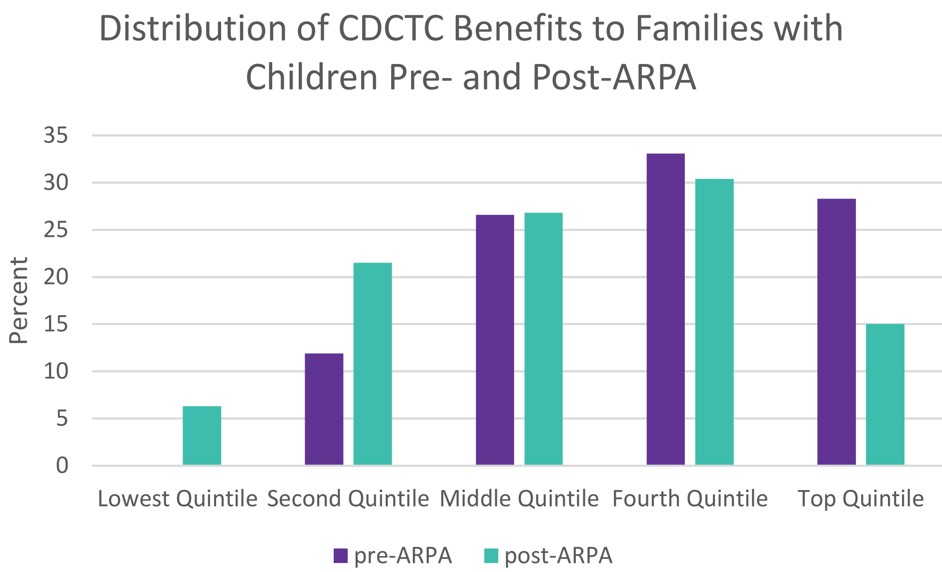
In Tax Year 2020, a single mother with two children who is paid $14,500 per year and spends $2,000 on child care expenses would be theoretically eligible to receive a $700 credit (35 percent of $2,000). However, because she would only owe $195 in federal income taxes, she would not get the full value of this credit—she would lose out on $405 in tax assistance. (This assumes that only the CDCTC is applied against tax liability, and does not take the CTC, EITC, or any other tax credits into account.)

Temporary improvements to the CDCTC will help millions of women and families meet their child care costs in 2021.

The ARPA expanded and improved the CDCTC for tax year 2021. Under the ARPA, families can claim up to $8,000 in expenses for one child or dependent and up to $16,000 in expenses for two or more children or dependents—previously they could only claim $3,000 and $6,000, respectively. Families with AGI up to $125,000 can claim up to 50 percent of eligible expenses (up from a maximum of 35 percent previously), and the percentage declines as income rises, down to 20 percent. Families with incomes above $440,000 are not eligible for the credit. For tax year 2021, the CDCTC is worth a maximum of $4,000 for one child or dependent, and $8,000 for two or more children or dependents.[18]

The Act also makes the credit refundable, meaning that more low- and moderate-income families will be able to benefit from the credit. In fact, some families struggling with child care costs will be able to claim the CDCTC for the first time. Just making the credit fully refundable would help reduce child poverty by 9.2 percent over ten years, according to an analysis by First Focus.[19]

Among families with children, almost 28 percent of the CDCTC's benefits will go to families making less than $34,800 a year—whereas previously these families only received roughly 12 percent of the benefits (see bottom two quintiles in chart below).[20] The expanded credit will reach more than half a million additional families with children.[21] In addition, many states offer child and dependent care tax credits based on the federal CDCTC, so improvements to the federal credit may automatically boost the value of some of these credits—which will benefit tax filers in those states.[22]



Sources: Tax Policy Ctr., T21-0047 – Tax Benefit of the Child and Dependent Care Tax Credit (CDCTC) under Pre-American Rescue Plan Act Law, by Expanded Cash Income Percentile, 2021 (March 23, 2021), https://www.taxpolicycenter.org/model-estimates/tax-benefits-provisions-affecting-children-march-2021/t21-0047-tax-benefit-child-and; Tax Policy Ctr., T21-0053 – Tax Benefit of the Child and Dependent Care Tax Credit, by Expanded Cash Income Percentile, 2021 (March 23, 2021), https://www.taxpolicycenter.org/model-estimates/tax-benefitsprovisions-affecting-children-march-2021/t21-0053-tax-benefit-child-and

Illustrative Example of How the CDCTC Will Work for Tax Year 2021

In Tax Year 2021, a single mother with two children who is paid $14,500 per year and spends $2,000 on child care expenses will be eligible to receive a $1,000 credit (50 percent of $2,000). And because the CDCTC is now fully refundable, she will receive the full value of the credit. The credit will reduce her $195 tax bill to zero and give her the remaining $805 as a tax refund. (This refund amount is calculated just from the CDCTC—not taking the CTC, EITC, or any other refundable tax credits into account.)

Unless the improvements are made permanent, low- and moderate-income families will lose the benefits of the expanded credit.

The CDCTC expansions are set to expire after only a year, which would take away critical support from women and families who will likely still be struggling to emerge from a recession. These expansions are common-sense improvements that address inequities that existed long before the pandemic—and that will continue to undermine women's financial security unless permanent changes are made.

However, even if the improvements to the CDCTC are made permanent, women and families still need robust increases in direct child care assistance. Expanding the CDCTC permanently would help some families offset their out-of-pocket child care expenses, but it would not address many of the other urgent concerns the child care system faces, including health and safety, provider supports, a well-trained and fairly compensated workforce with the ability to join a union, adequate child care supply, or virtual services.[23] In addition, while a tax credit can help reimburse families for expenses paid during the year, because child care costs are ongoing and generally a large share of their monthly expenses, families struggle to "float" until filing their annual taxes.[24]

For all of these reasons, a permanent expanded tax credit is a complementary—not a primary—tool for stabilizing and rebuilding the child care sector.

Permanent improvements to the CDCTC and investments in direct child care assistance will help rebuild a more equitable economy for women and families.

Women, especially single parents, continue to bear the bulk of responsibility for care of children and dependents. They have also been disproportionately devastated by the COVID-19 health and economic crisis, and the resulting shock to the child care industry. Permanently improving the federal CDCTC would help women meet the child care costs they incur to support themselves and their families.

But these permanent improvements to the CDCTC must be paired with a significant additional investment in direct child care assistance in order to build a child care system that meets the needs of children, families, and the child care workforce. While a tax credit targeting families' child care costs can play a small, complementary role in helping to offset the cost of care for families, addressing the range of urgent needs in the child care crisis before us requires an influx of direct spending on a permanent basis.[25]

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