ISSUE BRIEF

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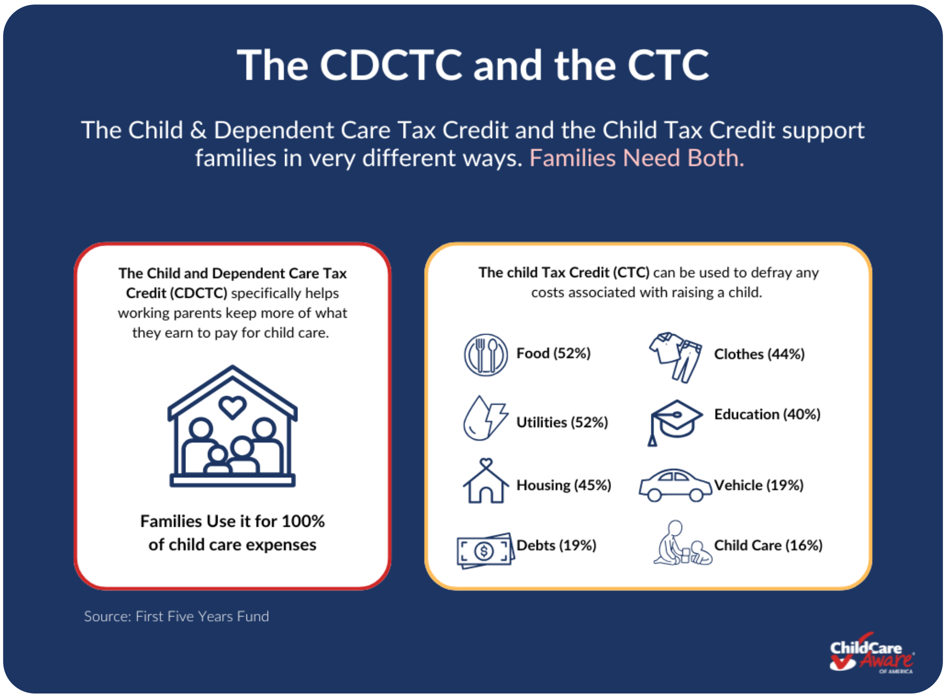
Child Care Tax Credits

BACKGROUND



Working families across the country depend on quality, affordable, and reliable child care—but this care is often too costly and difficult to find. These challenges have a devastating impact on our youngest learners, parents, as well as employers, and the health of our economy, which relies on a stable workforce. Combined with federal investments in early learning and child care programs, updating provisions of the United States tax code would help families better afford child care.

In addition to the Child Tax Credit (CTC), which can be claimed by parents to help with the costs of raising a child, there are child care-specific tax credits that are critical tools for both improving access to care for working families and supporting employers connect their employees with child care options. Updating provisions of the federal tax code is an important part of the solution, benefiting working parents and supporting economic stability across the country.

The federal tax code provisions designed to help offset the high cost of child care include:

The Child and Dependent Care Tax Credit (CDCTC) is the only tax credit designed specifically to help parents offset the cost of child care.

- *What it is:* Taxpayers can decrease expenses for child care (children under the age of 13) and adult dependents by claiming a maximum of $3,000 for one dependent ($6,000 for two or more) on their annual income taxes.
- *Limitations:* The credit is nonrefundable, if the value of the credit exceeds the amount owed, any balance is not paid to the family. The credit has not been updated since 2001 and is also not indexed to inflation, the maximum credit is still a small fraction of the price of care and has not increased to meet rising costs.
- *What Congress can do:* Increase the credit amount and index the maximum credit to inflation, updating the credit to reflect the realities of child care costs today. Make the credit fully refundable, allowing families with low-income to receive the full benefit.

The Dependent Care Assistance Program (DCAP) allows some working parents to set aside a small amount of their pre-tax paycheck to pay for child care expenses.

- *What it is:* Employee benefit plan—or flexible spending account—that allows employees to deduct $5,000 annually ($2,500 for married parents filing separately) pre-tax to pay for dependent care. Employers can contribute to an employee's DCAP.
- *Limitations:* Only parents working with participating employers can access, the maximum deduction does not sufficiently offset the high cost of care, and multiple children are not considered. DCAP does not compliment the CDCTC. Parents who maximize DCAP cannot claim the CDCTC for additional out-of-pocket expenses.
- *What Congress can do:* Increase the maximum deduction, decouple DCAP exclusions from CDCTC, allowing parents to claim the maximum CDCTC credit, regardless of DCAP contribution.

The Employer-Provided Child Care Credit (known as 45F) is available to businesses who want to provide or defray the cost of child care for their workforce. The credit rate is 25% of qualified child care expenses plus 10% of qualified resource and referral expenses.

- *What it is:* Businesses can receive a tax credit to offset some costs incurred by providing child care to their employees.
- *Limitations:* A business must spend $600,000 to receive the $150,000 maximum allowable credit, making it hard for small businesses to spend enough on child care to benefit, the credit is nonrefundable, meaning nonprofits and other businesses without federal tax liability cannot participate, low take-up rate due to these challenges.
- *What Congress can do:* Incentivize take-up by increasing the maximum credit and credit rate, making the credit fully refundable, and developing tiered credit rates for small and rural employers. Simplify the contract process with qualified child care providers.

POLICY CONSIDERATIONS

Child Care Aware of America recommends Congress protect and enhance these child care-specific tax credits to ensure that working families receive the support they need to make child care affordable.