Congressional Research Service
Informing the legislative debate since 1914

Dependent Care: Current Tax Benefits and Legislative Issues

name redacted
Specialist in Income Security

February 4, 2015

Congressional Research Service
7-....
www.crs.gov
RS21466

CRS REPORT
Prepared for Members and
Committees of Congress

Summary

There are two tax benefits for families who pay for the care of dependents:

- the child and dependent care tax *credit* (CDCTC) and
- the *exclusion* from income for employer-provided dependent care assistance programs (DCAPs).

The CDCTC directly reduces a taxpayer's income tax liability by the amount of the credit. The CDCTC is calculated as a percentage (a *credit rate*) of qualifying dependent care expenses. The credit rate is 35% for taxpayers with income of $15,000 or less, but it declines as income increases, to 20% for taxpayers with income over $43,000. Qualifying expenses are limited to $3,000 for one dependent and $6,000 for two or more dependents. For example, for a taxpayer with one dependent and income over $43,000, the maximum credit is $600 (20% of $3000).

People who are eligible for the maximum credit rate of 35% generally do not benefit from the CDCTC because the credit is not refundable. A nonrefundable tax credit cannot exceed the taxpayer's income tax liability. For example, a married couple with two children who have $15,000 of income will generally have no income tax liability. Thus, even if they were eligible under the formula for a $2,100 credit (35% of $6,000), they would not benefit from the CDCTC.

The *exclusion* from income for employer-provided DCAPs does not directly reduce tax liability but instead reduces a taxpayer's *taxable income* by the amount of qualifying expenses, which is limited to $5,000. The reduction in tax liability equals the qualifying expenses multiplied by the taxpayer's marginal tax rate. For example, if a taxpayer's marginal tax rate (the highest tax rate that applied to taxable income) was 25% and $1,000 of qualifying expenses were excluded from taxable income, the tax liability would be reduced by $250.

Both the credit and the exclusion use the same definition of dependent care expenses. The expenses must be incurred for the care of dependents under the age of 13 or for older dependents (including spouses) who are incapable of caring for themselves and must be necessary to allow taxpayers to work or look for work. Taxpayers may be able to benefit from the credit and the exclusion, but the same expenses cannot be used to claim both benefits.

In FY2015, the CDCTC is projected to reduce federal revenue by about $4.5 billion, and the exclusion is projected to reduce revenue by about $0.9 billion.

Some policy makers have expressed interest in changing the tax benefits for dependent care, most commonly to increase them. Possible approaches include increasing the amount of expenses that are excludible or credited, increasing the credit rate, making the credit refundable, and broadening the definition of dependent. In the President's 2016 budget, the Administration proposed increasing the maximum credit for families with young children and increasing the income level at which the credit rate declines. Part of the costs of expanding the credit would be offset by eliminating the dependent care exclusion.

Contents

Figures

Tables

Contacts

Introduction

Two income tax provisions help taxpayers pay for the costs of caring for children and older dependents who cannot care for themselves. The child and dependent care tax *credit* (CDCTC) directly reduces the amount of income tax owed. Under current law, the CDCTC equals as much as 35% of up to $6,000 in expenses, but the actual benefit is generally less, especially for lower-income taxpayers because the credit is not refundable. Nonrefundable tax credits cannot be greater than the taxpayer's income tax liability and many low-income taxpayers have little or no income tax liability. The *exclusion* from income for employer-provided dependent care assistance programs (DCAPs) can reduce a taxpayer's tax liability indirectly, by reducing *taxable income* by up to $5,000.

In FY2015, the CDCTC is projected to reduce federal income tax revenue by about $4.5 billion, and the exclusion is projected to reduce income tax revenue by about $0.9 billion.[1]

One reason for the federal government to support child and dependent care expenses is that those costs are viewed as employment-related expenses, which are often subtracted from taxable income. Another goal of supporting care is to encourage work.[2]

This report discusses current tax treatment of dependent care expenses under those two provisions and options for changing those policies.

The federal government also supports child care through the Child Care and Development Block Grant, which provides formula grants to states to subsidize the cost of child care for low-income working families. FY2015 appropriations for that program total $5.3 billion: $2.4 billion in discretionary funds and $2.9 billion in mandatory funds. For more information, see CRS Report RL30785, *The Child Care and Development Block Grant: Background and Funding*, by (name red acted).

Current Tax Benefits for Dependent Care

The credit and the exclusion use the same definition of qualified employment-related expenses and qualifying dependent. They differ, however, in how each affects tax liability. The CDCTC is a nonrefundable tax credit, so it directly reduces income tax liability for working caregivers by the amount of the credit, but not by more than what income tax liability would be without the credit. In contrast, the exclusion reduces a worker's taxable income, so its value depends on the taxpayer's marginal tax rate. In addition, the exclusion is available only to working taxpayers whose employers offer it as a benefit.

[1] U.S. Department of the Treasury, *Fiscal Year 2016 Tax Expenditures*, Table 1. Estimates of Total Income Tax Expenditures for Fiscal Years 2014-2024, lines 116 and 122, p.25, at http://www.treasury.gov/resource-center/tax-policy/Documents/Tax-Expenditures-FY2016.pdf#25.

[2] Congressional Budget Office, "Option 13: Eliminate Tax Subsidies for Child and Dependent Care," in *Budget Options, Volume 2,* August 2009, p.197, at http://www.cbo.gov/sites/default/files/cbofiles/ftpdocs/102xx/doc10294/08-06-budgetoptions.pdf. For additional background, see "How Should Child Care Be Taxed?" in Leonard E. Burman, Elaine Maag, and Jeffrey Rohaly, *Tax Subsidies to Help Low-Income Families Pay for Child Care*, Tax Policy Center Discussion Paper no. 23, June 2005, at http://www.taxpolicycenter.org/UploadedPDF/411190_TPC_DiscussionPaper_23.pdf, and Alan D. Viard, "The Child Care Tax Credit: Not Just Another Middle-Income Tax Break," *Tax Notes,* September 27, 2010, pp.1397-1403, at http://www.aei.org/wp-content/uploads/2011/10/On-the-Margin-Sep-27-2010.pdf.

Qualified Employment-Related Expenses

Qualified employment-related expenses are defined[3] as expenses incurred by taxpayers for a dependent's care and that enable taxpayers to be gainfully employed while a qualifying dependent is a member of their household.[4] Gainful employment includes work done at home, self-employment, and part-time employment. Employment-related expenses also include expenses incurred while a taxpayer is actively looking for work. However, taxpayers must earn income to claim the credit.

Qualified expenses include the costs of

- in-home care, including household services that are at least partly for the well-being and protection of a qualifying person;
- care provided outside the home at a dependent care center or camp for a dependent under the age of 13 or for any other qualifying person who regularly spends at least 8 hours each day at the taxpayer's home;[5]
- transportation for the dependent to and from the place where care is provided, but excludes transportation for an in-home care provider.

Expenses that *do not qualify* for the credit or exclusion include food, lodging, clothing, education, and entertainment. Thus, costs of institutional care in a nursing home or assisted living facility are not included, nor are the costs of kindergarten or higher grades. Qualified expenses may include payments to family members, but they do not include payments to a child of the taxpayer under the age of 19 or to an individual the taxpayer can claim as a dependent for the personal exemption.

Definition of Qualified Dependent

For the purposes of the dependent care tax benefits, qualifying dependents include

- a child who is under age 13 and the taxpayer's dependent (i.e., for whom the taxpayer can claim a personal exemption); and
- the spouse or dependent who is physically or mentally incapable of providing self-care and who lived with the taxpayer for at least half of the year.

The Child and Dependent Care Tax Credit

The CDCTC is calculated as a credit rate multiplied by a dollar amount of qualifying employment-related dependent care expenses, but the credit is limited to the taxpayer's income tax liability. The credit rate ranges from 20% to 35%, depending on the taxpayer's adjusted gross income (AGI). Qualifying employment-related expenses are limited to $3,000 for taxpayers with one qualifying dependent and $6,000 for those with two or more qualifying dependents. The $6,000 limit for two or more dependents *is not* capped at $3,000 per dependent. For example, if

---

[3] See Internal Revenue Code (IRC) §21(b)(2)(A) and IRC §129(e)(1).

[4] For details on the credit, see Internal Revenue Service, *Child and Dependent Care Expenses*, Publication 503, http://www.irs.gov/pub/irs-pdf/p503.pdf, and for details on the exclusion, see "Dependent Care Assistance" in Internal Revenue Service, *Employer's Tax Guide to Fringe Benefits*, Publication 15-B, at http://www.irs.gov/pub/irs-pdf/p15b.pdf.

[5] A dependent care center is a place that provides care for more than six persons and receives a fee, payment, or grant for providing services to any of those persons, even if the center is not run for profit.

the taxpayer has two qualifying dependents, one with expenses of $4,000 and the other of $2,000, the taxpayer can claim $6,000 of qualifying expenses for purposes of calculating the credit. If the taxpayer had one qualifying dependent with $4,000 of expenses, he or she can only claim $3,000 of expenses for the purposes of the credit.

The current parameters were effective in 2003, were set by the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA; P.L. 107-16), and were made permanent by the American Taxpayer Relief Act of 2012 (P.L. 112-240). Before 2003, the maximum credit rate was 30% instead of 35%; the limits on qualifying expenses were $2,400 for one dependent and $4,800 for two or more dependents.

For married taxpayers, qualified expenses are generally limited to the lesser of the taxpayer's or spouse's earned income. If the spouse is a full-time student or incapable of providing self-care, however, the spouse's monthly income for purposes of calculating the credit is assumed to be $250 for one child and $500 for two or more dependents. If the spouse is a full-time student all year, this results in an income for purposes of the credit equal to the qualified expense limitations of $3,000 for one child and $6,000 for two or more dependents. Married taxpayers must generally file a joint return to take the credit, but special rules exist for couples who are legally separated or living apart.

The CDCTC Credit Formula

The credit equals 35% of qualified expenses for taxpayers with AGI of up to $15,000. The 35% rate is reduced by one percentage point for each $2,000 (or fraction thereof) by which income exceeds $15,000, to a minimum of 20% for those with income of more than $43,000, as shown in **Table 1**.

Table 1. Maximum Child and Dependent Care Tax Credit, by Adjusted Gross Income and Number of Qualifying Individuals

Adjusted Gross Income		Applicable Credit Rate	Maximum Credit Based on Number of Qualifying Individuals	
Over	But Not Over		One ($3,000 in qualified expenses)	Two or More ($6,000 in qualified expenses)
$0	$15,000	35%	$1,050	$2,100
15,000	17,000	34	1,020	2,040
17,000	19,000	33	990	1,980
19,000	21,000	32	960	1,920
21,000	23,000	31	930	1,860
23,000	25,000	30	900	1,800
25,000	27,000	29	870	1,740
27,000	29,000	28	840	1,680
29,000	31,000	27	810	1,620
31,000	33,000	26	780	1,560
33,000	35,000	25	750	1,500
35,000	37,000	24	720	1,440
37,000	39,000	23	690	1,380

Adjusted Gross Income		Applicable Credit Rate	Maximum Credit Based on Number of Qualifying Individuals	
Over	But Not Over		One ($3,000 in qualified expenses)	Two or More ($6,000 in qualified expenses)
39,000	41,000	22	660	1,320
41,000	43,000	21	630	1,260
43,000	No limit	20	600	1,200

Source: Internal Revenue Service (IRS), Publication 503, *Child and Dependent Care Expenses*.

Note: These credit rates apply to all filing statuses.

Statutory Versus Actual Credit Amounts

Using the CDCTC formula, the maximum statutory credit amount is $1,050 (for one dependent) or $2,100 (for two or more dependents). However, the credit is nonrefundable, so the effective credit is limited to a taxpayer's income tax liability (as computed without the credit). Hence, taxpayers with little or no income tax liability, including many low-income taxpayers, generally benefit little from nonrefundable tax credits. For example, a married couple with two children will generally owe no income taxes in 2015 if their income is less than $28,600.[6] Even if the family were eligible for the CDCTC using the credit formula, they would not receive the credit because they have no income tax liability for the tax credit to offset.

Figure 1 and **Figure 2** below compare the "statutory credit amount" (i.e., the credit rate multiplied by maximum expenses as shown in **Table 1**) with the effective credit (i.e., the actual amount by which income taxes are reduced) for typical taxpayers.[7] (Actual taxpayers' income tax liabilities and credit amounts may differ from those shown.) The taxpayer's dependent care expenses are assumed to be the maximum allowable expenses for the credit—$3,000 for one dependent and $6,000 for two or more dependents.

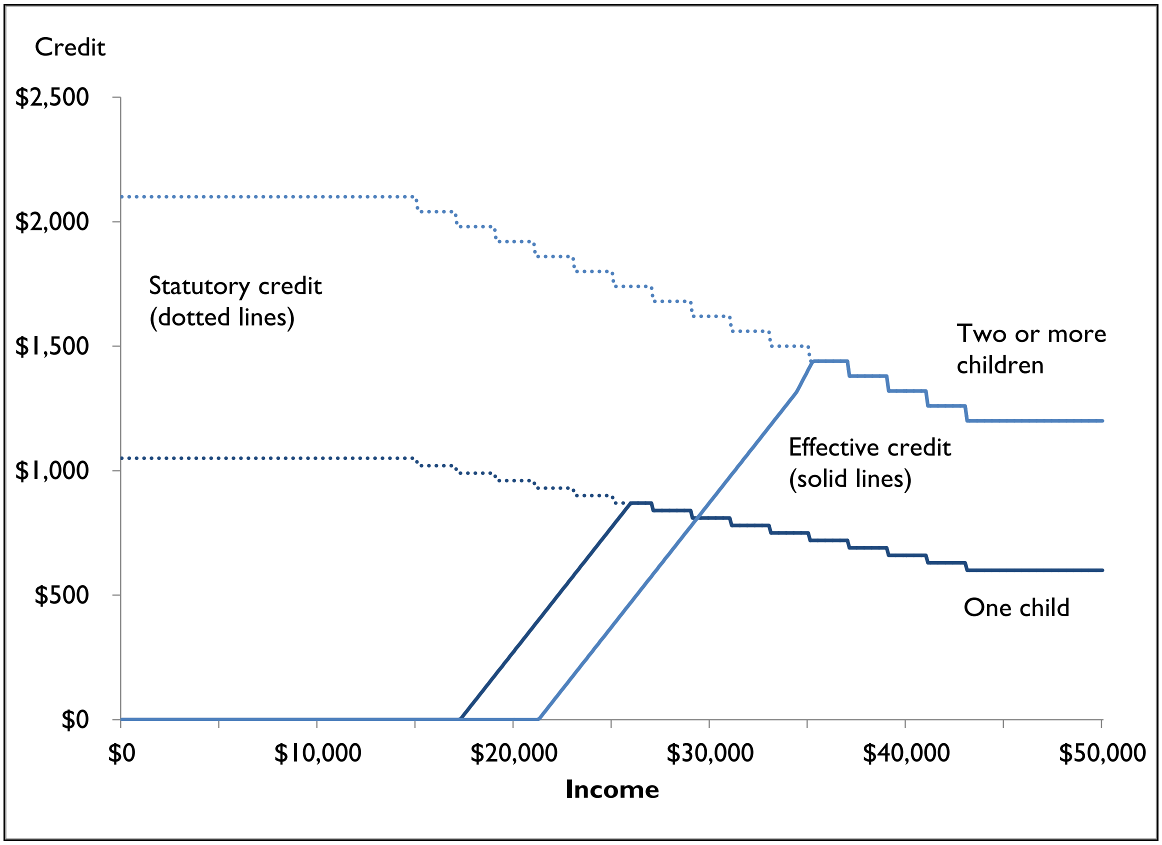
Figure 1 illustrates the statutory and effective credit amount for taxpayers who file their tax returns as head of household (generally, the filing status used by single parents with dependent children) and have either one child or two or more children. Based on the simplifying assumptions, such taxpayers would owe no taxes until their income was greater than $17,250 (for one child) or $21,250 (for two or more children). Hence, they would not receive the CDCTC if their income was below these levels. Once their income exceeded these thresholds, the credit would equal their income tax liability, which is less than the statutory credit amount. And once income was greater than $25,950 (for one child) or $35,240 (for two or more children), the taxpayers would receive the full statutory credit amount.

[6] This example assumes that all income is from wages and that taxpayers take no above-the-line deductions or any other nonrefundable credits. Therefore, their taxable income equals wages minus the standard deduction and the personal exemption amounts.

[7] The calculations use 2015 tax rates, standard deductions, and exemption amounts for head of household tax filers and married filed jointly filers. The examples also assume that tax filers have only wage income, do not claim any above-the-line deductions or other nonrefundable credits, and have either one or two children. In addition, these figures assume that the two dependents are children, although the CDCTC also applies to adults. For background, see "The Structure of the Federal Individual Income Tax," in CRS Report RL32808, *Overview of the Federal Tax System*, by (name redacted) and (name redacted) . For 2015 income tax parameters, see the Internal Revenue Service (IRS) revenue procedure 14-61 at http://www.irs.gov/pub/irs-drop/rp-14-61.pdf.

Figure 1. Maximum Statutory and Effective Child and Dependent Care Credit

Head of Household Filers, 2015



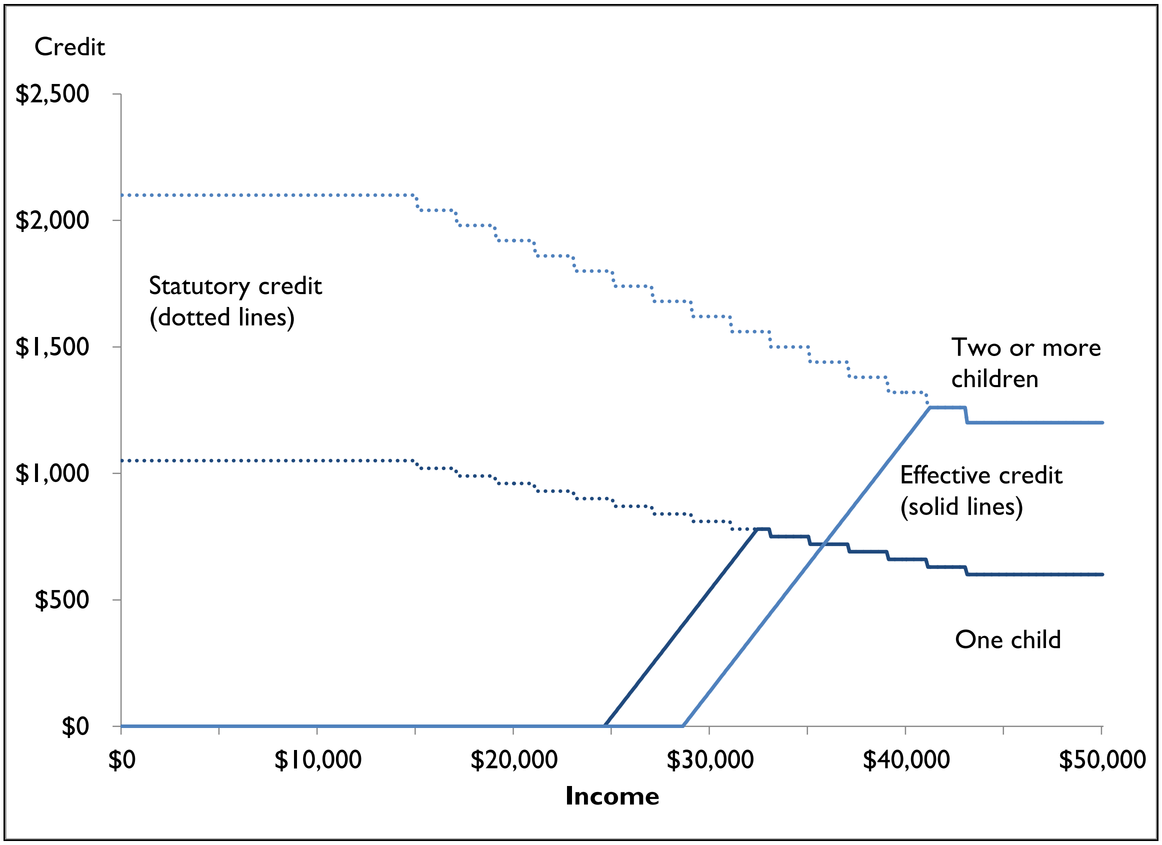
Source: Congressional Research Service (CRS).

Notes: Calculations assume $3,000 in qualified expenses for one child and $6,000 for two or more children.

Figure 2 illustrates the statutory and effective credit amount for taxpayers who file their tax returns as married filing jointly and have either one child or two or more children. Based on the simplifying assumptions, such taxpayers would owe no taxes until their income was greater than $24,600 (for one child) or $28,600 (for two or more children). Hence, they would not receive the CDCTC if their income was below these levels. Once their income exceeded these thresholds, the credit would equal their income tax liability, which is less than the statutory credit amount. And once their income was greater than $32,400 (for one child) or $41,200 (for two or more children), the taxpayers would receive the full statutory credit amount.

Figure 2. Maximum Statutory and Effective Child and Dependent Care Credit

Married Filing Jointly Filers, 2015



Source: CRS.

Notes: Calculations assume $3,000 in qualified expenses for one child and $6,000 for two or more children.

Distribution of Credit Benefits by Income

The CDCTC largely benefits middle- and upper-income taxpayers. In 2012, 6.3 million returns used the CDCTC for a total credit of $3.4 billion.[8] Because the credit is nonrefundable, few lower-income taxpayers benefit from it. For example, in 2012, only about 8,000 taxpayers with AGI under $15,000 benefited from the CDCTC, because people in that income range generally had no income tax liability for the credit to reduce. As shown in **Table 2**, about half of the dollar value of the CDCTC was claimed by households with an AGI of more than $75,000.

Table 2. Use of the Child and Dependent Care Tax Credit, by Adjusted Gross Income, 2012

Adjusted Gross Income	Percentage of all tax returns	Percentage of Returns Claiming the CDCTC	Average CDCTC	Share of Total CDCTC Claimed
$0 up to $15,000	26%	0.0%	$116	0%

[8] IRS, *Individual Complete Report (Publication 1304)*, Table 3.3, available at http://www.irs.gov/uac/SOI-Tax-Stats-Individual-Income-Tax-Returns-Publication-1304-%28Complete-Report%29.

Adjusted Gross Income	Percentage of all tax returns	Percentage of Returns Claiming the CDCTC	Average CDCTC	Share of Total CDCTC Claimed
$15,000 up to $25,000	15	2.3	348	5
$25,000 up to $40,000	16	4.8	593	19
$40,000 up to $50,000	8	5.0	530	8
$50,000 up to $75,000	13	5.9	533	17
$75,000 up to $100,000	8	8.3	555	16
$100,000 up to $200,000	11	10.3	556	26
$200,000+	4	8.8	540	7
All Taxpayers	**100**	**4.4**	**538**	**100**

Source: CRS based on IRS, SOI Tax Stats - Individual Income Tax Returns (Publication 1304), Table 3.3, 2012.

Employer-Provided Dependent Care Assistance Programs

A taxpayer can exclude from their income up to $5,000 of dependent care expenses associated with an employer-provided dependent care assistance program (DCAP). The definitions for qualified dependent care expenses and qualified dependent used for the exclusion are the same as for the CDCTC.

An employer can provide direct payment to child care and adult day care providers, provide on-site child care, or reimburse employees for child care they obtain. Arrangements can also be funded through salary reduction agreements. Under a salary reduction agreement, the employee agrees that a specified amount be set aside for the employer's DCAP.[9] The employer DCAP must be a written plan that is generally available to all employees, but it need not be funded by the employer.

The tax benefit from the exclusion depends on the marginal tax rate of the working caregiver and the amount that the working caregiver allocates to the DCAP each year. The marginal tax rate is the tax rate on the last dollar that the person earned that year and increases with taxable income. Currently, there are seven marginal income tax rates, ranging from 10% to 39.6%, depending on the taxpayer's taxable income.[10] The working caregiver also does not pay Social Security and Medicare payroll taxes on the contribution to the DCAP. In most cases, the total payroll tax rate is 15.3%.[11]

Higher-income individuals, who pay higher marginal tax rates, receive a larger reduction in their taxes, in dollar amounts, than middle- and lower-income individuals. For example, a taxpayer

[9] The plan will then reimburse the employee from the set aside amount (i.e., employee contributions) for dependent care expenses. This type of arrangement is also known as a flexible spending arrangement or flexible spending account, and is often offered as part of a cafeteria benefit plan, in which employees may choose from one or more taxable or nontaxable benefits.

[10] For more information, see IRS revenue procedure 14-61 at http://www.irs.gov/pub/irs-drop/rp-14-61.pdf/.

[11] That 15.3% rate consists of a 12.4% Social Security payroll tax on earnings up to a limit, which is $118,500 in 2015, and a 2.9% Medicare payroll tax on all earnings. Higher-income workers are also subject to an additional 0.9% Medicare payroll tax. See IRS, "Topic 751 - Social Security and Medicare Withholding Rates," at http://www.irs.gov/taxtopics/tc751.html. The 15.3% rate is legally split between employers and employees, but most analysts believe that employers' share of payroll taxes are passed on to employees in the form of lower wages.

with $5,000 in qualifying child care expenses and a marginal income tax rate of 10% would save $500 in income taxes from the exclusion. With a marginal income tax rate of 39.6%, the income tax savings would be $1,980.

In 2010, the most recent year for which data are available, 1.2 million tax returns excluded dependent care benefits; the exclusion reduced taxable income on those returns by an average of $3,456.[12] The reduction in taxes was much smaller, because it equals the taxpayer's marginal tax rate multiplied by the reduction in taxable income. In 2010, the average income tax benefit for people using the exclusion was around $1,000.[13]

According to a Mercer survey, 58% of employers with 50 to 499 employees and 85% of employers with 500 to 4,999 employees offered a DCAP in 2012. The average contribution to a DCAP was about $3,300, which is lower than the $5,000 maximum allowed under current law.[14] This difference may reflect the "use or lose" nature of the funds and changes in employment (e.g., if an employee changes jobs from one employer that offers a DCAP to another that does not).[15] Funds for dependent care expenses not used by the end of the year revert to the employer.[16] The Mercer survey found that an average of about 2% of funds are forfeited under the use or lose rules.

Interaction Between the Dependent Care Credit and Exclusion

Although both provisions use the same definition of employment-related expenses, the same expenses cannot be used for both the credit and exclusion, and the total expenses used for both provisions cannot exceed $6,000. As previously discussed, the tax savings from the credit is equal to the lesser of the taxpayer's income tax or the statutory credit (i.e., the credit rate multiplied by the qualifying expenses). In comparison, the tax savings from the exclusion equals the taxpayer's marginal tax rate multiplied by the qualifying expenses. Therefore, taxpayers whose marginal tax rate exceeds their credit rate will generally benefit more from the exclusion.

In effect, the limit on qualifying expenses for one provision (either the credit or exclusion) is reduced by the amount used for the other provision. For example, if a taxpayer has two qualifying children and claims a credit based on $4,000 of expenses, no more than $2,000 in income can be excluded, because the $6,000 exclusion limit would be reduced by the $4,000 used for the credit. That rule applies even if the actual expenses exceed $6,000.

Because the credit has a higher limit than the exclusion for taxpayers with two or more dependents ($6,000 versus $5,000), a higher-income taxpayer with $6,000 or more in qualifying expenses would generally benefit the most by excluding $5,000 from income and applying the remaining $1,000 of expenses to the credit.

[12] IRS, SOI Tax Stats - Individual Information Return Form W-2: Summary Statistics, Summary of Items for Taxpayers with Form W-2, by Return and Earner Type, 2010, at http://www.irs.gov/uac/SOI-Tax-Stats-Individual-Information-Return-Form-W2:-Summary-Statistics.

[13] The reduction in federal income taxes in 2010 was $1,220 million; see Office of Management and Budget, *Analytical Perspectives, Budget of the United States Government, Fiscal Year 2012*, Table 17-1. Estimates of Total Income Tax Expenditures for Fiscal Years 2010-2016, line 117, p.243, at http://www.gpo.gov/fdsys/pkg/BUDGET-2012-PER/pdf/BUDGET-2012-PER.pdf.

[14] Mercer Human Resource Consulting, "National Survey of Employer Sponsored Health Plans," released February 2013, p.88, at http://benefitcommunications.com/upload/downloads/Mercer_Survey_2013.pdf.

[15] Employers at their discretion may extend the deadline for using unspent balances up to 2½ months after the end of the plan year.

[16] See CRS Report RL32656, *Health Care Flexible Spending Accounts*, by (name redacted) .

Issues for Congress

A key issue Congress may consider is whether these provisions are adequately addressing the costs for working caregivers. In recent years, legislation has been introduced to expand dependent care tax benefits, and the Obama Administration has also proposed expanding these benefits. To increase dependent care benefits, Congress may, for example, consider

- increasing the credit amount,
- making the credit refundable, and
- broadening the definition of dependent.

Alternatively, Congress may wish to reduce or eliminate some or all of the benefits to obtain budgetary savings or to simplify the tax code. For example, the draft Tax Reform Act of 2014 would have eliminated the CDCTC as part of a consolidation of family tax credits into an increased child credit and standard deduction.[17]

Increase the Credit Amount

A taxpayer's credit amount for the CDCTC equals the credit rate multiplied by qualified expenses. Therefore, the credit amount could be increased by increasing the credit rate, the limit on qualified expenses, or both. Similarly, the value of the exclusion could be increased by raising the limit on excludible expenses.

Neither the $3,000 nor $6,000 limit on qualifying expenses for the credit nor the $5,000 limit for the exclusion maximum is indexed for inflation, and dependent care costs often far exceed those thresholds. For example, the average annual cost of full-time, center-based care for an infant in 2013 ranged from $5,496 in Mississippi to $16,549 in Massachusetts.[18] Eldercare is also expensive: The median annual cost of adult health day care is around $17,000.[19]

Some proposals would increase the amount of the exclusion and credit by indexing the amounts to inflation, directly increasing them, or both. For example, the Helping Working Families Afford Child Care Act (S. 2565 of the 113th Congress) would have increased the limits on qualifying expenses to $8,000 for one child and $16,000 for two or more children. That bill would have also set the credit rate at 20% for all filers with income of less than $200,000, for a maximum credit of $1,600 for one child and $3,200 for two or more children. The credit rate would have decline at incomes above $200,000, reaching zero for taxpayers with income of more than $290,000. The proposal would have also made the credit refundable, and it would have indexed the limits on qualifying expenses and income to inflation. A similar proposal was made by Representative Van Hollen at the beginning of the 114th Congress.[20]

---

[17] U.S. Congress, "Sec. 1301. Repeal of dependent care credit," in House Committee on Ways and Means, *Tax Reform Act of 2014, Discussion Draft, Section-by-Section Summary*, February 26, 2014, p. 13, at http://waysandmeans.house.gov/uploadedfiles/ways_and_means_section_by_section_summary_final_022614.pdf.

[18] Child Care Aware of America, "Parents and the High Price of Child Care: 2014 Report," November 2013, p.21, available at http://usa.childcareaware.org/costofcare.

[19] Genworth Financial, "2014 Cost of Care Survey: Home Care Providers, Adult Day Care, Health Care Facilities, Assisted Living Facilities and Nursing Homes, p.18, at https://www.genworth.com/dam/Americas/US/PDFs/Consumer/corporate/130568_032514_CostofCare_FINAL_nonsecure.pdf.

[20] Rep. Chris Van Hollen, "An Action Plan to Grow the Paychecks of All, Not Just the Wealth of a Few," at the Center for American Action Fund, January 12, 2015, at http://democrats.budget.house.gov/action-plan. That plan did not specify an exact credit rate but instead proposed a credit rate of "20 to 25 percent."

The Child Care Flex Spending Act of 2013 (S. 1713 and H.R. 3497 of the 113th Congress) would have increased the exclusion limit from $5,000 to $10,000 for married taxpayers with an AGI of less than $200,000; those amounts would have been also indexed to inflation.

Another way to increase the value of the CDCTC would be to increase the applicable credit rate, for example, by adjusting or eliminating the income-related phasedown. Under current law, the credit rate declines from 35% to 20% as a taxpayer's income increases. For example, the Middle Class Dependent Care Fairness Act of 2013 (H.R. 2048 of the 113th Congress), the Support Working Parents Act of 2013 (H.R. 1978 of the 113th Congress), and the Tax Credit for Early Educators Act of 2013 (S. 438 of the 113th Congress) would have repealed the phasedown, so the 35% credit would have applied regardless of income.

The two approaches could be combined. For example, the Right Start Child Care and Education Act of 2013 (H.R. 3101 and S. 56 in the 113th Congress) would have increased the limits on qualifying expenses for both the credit and the exclusion and would have also increased the credit rate.

Expand the Benefit to Lower-Income Taxpayers by Making the Credit Refundable

The CDCTC is generally unavailable to lower-income taxpayers because it is nonrefundable. It therefore cannot be used in full when income tax liability is less than the amount of the credit and cannot be used at all if the household has no income tax liability. If the credit were made refundable, then all taxpayers would receive the full credit amount, regardless of their income tax liability.

Lower-income households would benefit the most if the tax credit were made refundable. As shown above in **Table 2**, few low-income households now receive the credit, because they generally have no income tax liability.

The Tax Policy Center estimated that if the CDCTC were made refundable (but all other parameters remained as under current law), taxes would be reduced for 0.9% of tax units in 2015, and the average reduction for those units would be $637. That would result in about $1 billion less federal revenue each year. About 95% of that reduction in revenue would go to families with annual income of less than $50,000.[21]

The Helping Working Families Afford Child Care Act, described above, would have made the credit refundable. The independent Tax Policy Center estimated that overall, the bill would have more than doubled annual spending on the credit, to about $7 billion.[22] Because the proposal would be refundable, the increase in the credit would be largest for lower-income tax filers. The Child Care Access and Refundability Expansion Act (H.R. 3740 in the 113th Congress) and the

[21] Tax Policy Center, "Make the Child and Dependent Care Credit Fully Refundable, Distribution of Federal Tax Change by Expanded Cash Income Level, 2015," T13-0277, December 6, 2013, at http://www.taxpolicycenter.org/numbers/displayatab.cfm?Docid=4012, and "Options for the Child and Dependent Care Credit, Change in Individual Income Tax Revenue," T13-0293, December 6, 2013, at http://www.taxpolicycenter.org/numbers/displayatab.cfm?Docid=4011. For additional analysis of this and other options, see "Options for the Child and Dependent Care Credit" at http://www.taxpolicycenter.org/numbers/displayatab.cfm?template=simulation&SimID=481&bydate=1.

[22] Elaine Maag, "The 'Helping Working Families Afford Child Care Act" Would Help, but Doesn't Solve the Timing Mismatch,'" July 28, 2014 at http://taxvox.taxpolicycenter.org/2014/07/28/helping-working-families-afford-child-care-act-help-doesnt-solve-timing-mismatch/#sthash.73u6hLLn.dpuf.

Right Start Child Care and Education Act of 2013 (H.R. 3101 and S. 56 in the 113th Congress) would have also made the credit refundable.

A proposal developed by University of Kentucky economist James P. Ziliak would target child and dependent care benefits to lower-income families, in part by making the credit refundable. Under that proposal, families with younger children would also receive larger credits than those with older children. The proposal would give larger credits to families whose children attended licensed, center-based child-care facilities than to those whose children used other types of care in order to encourage families to choose higher quality child care.[23]

Broaden the Definition of Eligible Dependents

Another option is to broaden the definition of eligible dependents. One way of doing that would be to make people who do not live with the care provider, such as aging parents or relatives, eligible for the credit. The Elder Care Tax Credit Act of 2014 (H.R. 4145 in the 113th Congress) would have made that change.

As noted earlier, under current law, to qualify for benefits, the dependent must live with the working caregiver for more than half the year. However, some taxpayers pay for care of dependents who live elsewhere and would not be able to work without that care. In such cases, the law could be difficult to administer with that broader definition, because the connection between the care provided and the taxpayer's ability to work would not always be clear when the dependent did not live with the taxpayer.

The President's Proposal

The President's 2016 budget proposes increasing the CDCTC for families with young children, increasing the income limits at which the credit phases out, and eliminating the exclusion from income for employer-provided dependent care assistance programs.[24] The proposal would increase the cost of the tax preferences by an estimated $50 billion from FY2016 through FY2025.[25]

Families would be eligible for a maximum 50% credit on the first $6,000 in qualifying expenses for one child under the age of five and $12,000 for two children under aged five, for a maximum credit of $3,000 per child. For older children, the current $3,000 per child limit on qualifying expenses and 35% maximum credit rate would continue to apply.

The maximum credit rates of 50% for young children and 35% for older children would apply to families with income of less than $120,000, and those rates would decline by one percentage point for each additional $2,000 in income, to a minimum of 20%. As a result, for young children, the 20% rate would apply at incomes of more than $178,000; for older children, it would apply at incomes of more than $148,000. The limits on qualifying expenses and the income thresholds for the credit rate would be indexed to inflation.

[23] James P. Ziliak, "Supporting Low-Income Workers through Refundable Child-Care Credits," The Hamilton Project, June 2014, at http://www.hamiltonproject.org/papers/supporting_low-income_workers_refundable_child-care_credits/.

[24] Department of the Treasury, *General Explanations of the Administration's Fiscal Year 2016 Revenue Proposals,* February 2015, pp.126-127, at http://www.treasury.gov/resource-center/tax-policy/Documents/General-Explanations-FY2016.pdf#138.

[25] Ibid., pp.296.

The proposal would also increase funding for the Child Care and Development Fund; for background on that program, see CRS Report RL30785, *The Child Care and Development Block Grant: Background and Funding*, by (name redacted). Some analysts suggest that lower-income families are better supported through such direct spending rather than through a refundable tax credit because they may have difficulty paying for childcare before they receive the credit.[26]

Past budgets included different proposals. The President's 2015 budget proposed expanding the CDCTC by increasing the credit rate and the limit on qualifying expenses.[27] That proposal would have retained the current credit structure but added a supplemental credit rate of 30 percentage points for $4,000 in expenses for each of the first two children. The maximum total credit would then have been $2,250 for one child and $4,500 for two or more. The supplemental credit would have been phased out at higher incomes. The President's 2014 budget proposed increasing the income level at which the credit rate is reduced.[28] Under that proposal, the credit rate would have been 35% at income levels of $75,000 or less and would have declined to 20% at incomes of above $103,000.

Author Contact Information

(name redacted)
Specialist in Income Security
[redacted#@crs.loc.gov , 7-....

Acknowledgments

Former CRS Analyst Noah Meyerson was the author who most recently updated and rewrote this report. All inquiries on the topics covered by this report should be directed to the currently listed author.

[26] See Elaine Maag, "Obama Would Simplify and Expand Spending and Tax Subsidies for Child Care," Tax Policy Center, January 22, 2015, at http://taxvox.taxpolicycenter.org/2015/01/22/obama-simplify-expand-spending-tax-subsidies-child-care/.

[27] Treasury, *General Explanations of the Administration's Fiscal Year 2015 Revenue Proposals*, March 2014, p.145, at http://www.treasury.gov/resource-center/tax-policy/Documents/General-Explanations-FY2015.pdf#157.

[28] Treasury, *General Explanations of the Administration's Fiscal Year 2014 Revenue Proposals*, April 2013, p.128, at http://www.treasury.gov/resource-center/tax-policy/Documents/General-Explanations-FY2014.pdf#138.