

# Strengthening Child Care Tax Incentives to Support Working Families

Child care is not a luxury for American families—it's a necessity. Yet the costs associated with quality child care are rapidly out-pacing most other expenses faced by families, including the cost of higher education.

The U.S. has traditionally used the tax code to help address real-world problems, and to incentivize behaviors that result in overall economic benefits for Americans. For example, the tax code incentivizes people to save for retirement, encourages home-ownership and assists with college education through deductions and exclusions. **In the same way tax credits are used to make retirement and higher education more accessible, the tax code should also reflect that child care expenses are often directly linked to a parent's ability to work.**

Strengthening the Child and Dependent Care Tax Credit (CDCTC) will help working families who are struggling with the rising cost of quality child care, benefiting the workforce of today – and tomorrow.

According to a 2017 report from Child Care Aware of America, the average hourly cost of center-based care for a four-year old represents 24 percent of the median hourly wage across states. And only 15 percent of American voters say that most or all local programs available to lower- and middle-income families are high-quality and affordable. In fact, those making over \$100,000 per year are virtually just as likely as those who earn less than \$40,000 per year to say that few programs near them are affordable and high-quality.

This pervasive lack of access to affordable, quality child care impacts the economic mobility of our nation's families. 70 percent of nonworking poor adults with young children say that taking care of their family is a reason they're not in the workforce. And 75 percent of postsecondary students with children who dropped out of school say that child care would have helped them achieve their degree, while only 27 percent of students with children complete their degrees within six years.

Without question, making quality child care more accessible allows and encourages parents to enter or return to the labor force. But the resulting growth of the child care sector also stands to immediately benefit the U.S. economy. According to a new report from the Committee for Economic Development, the U.S. child care industry directly and indirectly supports an estimated \$99.3 billion in total U.S. output. The industry is made up of 675,000 small businesses and provides over 1.5 million jobs.

What's more, access to quality early learning affects more than just today's workforce—it has a real impact on the workforce of the future by allowing children to develop the skills they need for success later in life. While parents are working, crucial developmental experiences in quality child care build the cognitive and character skills that children need to do well in school and in life, including attentiveness, persistence, impulse control, and sociability. In fact, studies show that children—particularly those from low-income families—who receive a high-quality early childhood education are proven to be more likely to earn higher wages, live healthier lives, avoid incarceration, raise stronger families, and contribute to society.

While there are currently a handful of tax credits and deductions that support families with children, **only the CDCTC was designed to help working parents with the cost of work-related child care expenses.** Unfortunately, the CDCTC has not kept pace with the rising cost of child care and remains nonrefundable, making it unavailable to many working families with a lower or no tax liability.





## ● WHAT IS THE CHILD AND DEPENDENT CARE TAX CREDIT (CDCTC)?

The CDCTC was created in 1976 to help working families pay for qualified expenses associated with the care of children, as well as adult dependents. Congress approved a temporary increase to the credit in 2001, and in 2012 a bipartisan majority voted to make that permanent.

Today, the credit varies between 20 and 35 percent of qualified expenses up to \$3,000 per eligible child. Qualified expenses are capped at \$6,000. That means the maximum credit for working parents with two or more children is \$2,100 (35% of \$6,000) – only about 10 percent of the average annual cost of care for two children in the United States.

## ◆ WHY DO WE NEED AN EXPANDED CHILD AND DEPENDENT CARE TAX CREDIT?

We know that early childhood education from birth through age five results in positive economic returns for families and society. However, as a nation, we're struggling with high costs and a shortage of quality care providers. Making the CDCTC a more robust tax incentive will help by making child care more affordable while encouraging expansion of the child care sector, resulting in increased access.

The CDCTC's expense limits are also not indexed for inflation, so even as child care expenses have risen sharply since 2001, the credit has not changed to meet these increasing costs. What's more, the credit is not currently refundable. As a result, most low- and some middle-income, tax-paying families are unable to take advantage of it. The Tax Policy Center found that nearly 40 percent of the credit's value is claimed by families earning \$100,000 or more, while almost no families in lower tax brackets were able to access the credit.

## ■ WHAT IS THE PACE ACT?

The Promoting Affordable Childcare for Everyone (PACE) Act is a bipartisan proposal that makes critical reforms and updates to tax policies that help families care for children and dependents. There are two major provisions in the proposal that address the limits of the current tax code.

The first goal of the PACE Act is to improve and modernize the CDCTC by:

- Making the credit fully refundable;
- Increasing the value of the credit for a new top rate of 50%; and
- Indexing the credit to inflation to ensure it matches rising costs of child care into the future.

The second goal of the PACE Act is to enhance the Dependent Care Flexible Spending Accounts (FSAs) by:

- Increasing the amount of pre-tax dollars families can put into FSAs from \$5,000 to \$7,500. (This money is excluded from gross income and allows families to reduce their tax burden while paying for care for dependents); and
- Indexing the new cap to inflation so that it remains responsive to rising costs into the future.

## ▼ DIDN'T CONGRESS JUST INCREASE THE CHILD TAX CREDIT?

The Child Tax Credit (CTC), while important, is completely separate from the CDCTC. It is intended for families with dependent children and is designed to ensure the tax code reflects that families have more expenses and less disposable income than individuals and couples making the same amount without children.

During tax reform in 2017, the CTC was increased to \$2,000 per child. However, the CTC is not targeted at working parents and it is not tied to a child's care. Working and non-working parents may use the CTC for any expense, even those not related to the costs of raising children. However, only working parents pay taxes on the wages they earn and need tax relief for the child care costs that are directly associated with earning those wages. The CDCTC offers that assistance to working parents, thus providing families the chance to earn much-needed income, strengthen the American labor force, and ensure more children have access to high-quality early learning opportunities.

