FEDERAL TAX PROVISIONS SUPPORTING CHILD CARE

American families depend on affordable, reliable, quality child care to go to work – but this care is often hard to find and too costly. These challenges have a tremendous impact on our youngest learners and working parents, as well as employers and local economies who rely on a stable, reliable workforce.

When combined with federal investments in early learning and care programs, updating provisions of the United States tax code would help strengthen child care in the United States. Working together and alongside the Child Tax Credit (CTC), these tax provisions represent critical tools for both improving access to care for working families and supporting employers who share child care expenses with their employees.

1 CHILD AND DEPENDENT CARE TAX CREDIT (CDCTC)

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. The lowest income taxpayers receive 35% of those expenses as a credit, reducing their taxable income by a maximum of $1,050 for one dependent and $2,100 for two or more.

WHY IT'S IMPORTANT

- The only tax credit that directly helps working parents offset the cost of child care.

CURRENT LIMITATIONS

- Nonrefundable. If the value of the credit exceeds the amount owed, any balance is forfeited and not paid to the family. Therefore, families with low or $0 tax burden do not benefit.
- Disproportionately accessed by middle- and high-income families, rather than those most in need.
- Maximum credit is a small fraction of the price of care.
- Not indexed for inflation. As child care expenses have risen over the past three decades, the credit's value has not increased to meet rising costs.[1]

A PATH FORWARD: WHAT CAN CONGRESS DO?

- Make fully refundable, enabling low-income families to receive the full benefit.
- Increase the credit amount for low-earning families.
- Index the maximum credit to inflation.

2 EMPLOYER-PROVIDED CHILD CARE CREDIT (45F)

WHAT IT IS

- Businesses can receive a tax credit to offset some costs incurred by providing child care to their employees. Allowable costs: (1) purchasing, building, or updating property used to provide child care, (2) operating costs, including training, scholarships, and wages for child care staff (3) contracting with a qualified child care provider and (4) contracting for resource and referral services.

WHY IT'S IMPORTANT

- Supports both businesses and parents by incentivizing businesses to help employees access child care and increase the number of slots available in the community.

CURRENT LIMITATIONS

- Credit rate is 25% of qualified child care expenses plus 10% of qualified resource and referral expenses. 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.
- Nonrefundable. Nonprofits and other businesses without federal tax liability cannot participate.
- Low take-up rate due in part to the limited financial incentive it offers businesses.[2]

A PATH FORWARD: WHAT CAN CONGRESS DO?

- Increase the maximum credit and credit rate. Develop a tiered system with a greater credit rate for small employers and rural employers to incentivize take-up.
- Make fully refundable.
- Simplify the process for multiple employers to jointly enter a contract with a qualified child care provider.

3 DEPENDENT CARE ASSISTANCE PROGRAM (DCAP)

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. This reduces the overall tax burden and precludes these funds from being taxed. Employers can contribute to employees' DCAP, but the combined contribution cannot exceed $5,000.

WHY IT'S IMPORTANT

- Reduces parents' total tax amount and lowers out-of-pocket dependent care expenses by allowing the use of tax-free money.

CURRENT LIMITATIONS

- $5,000 maximum annual tax-free deduction does not sufficiently offset the high cost of child care, and multiple children are not considered.
- Only parents with participating employers can access this benefit.
- DCAP and CDCTC do not work in tandem. Parents who maximize DCAP cannot claim the CDCTC for additional out-of-pocket expenses.

A PATH FORWARD: WHAT CAN CONGRESS DO?

- Increase the maximum tax-free deduction to better reflect the true price of child care.
- Decouple DCAP exclusions from CDCTC, allowing taxpayers to claim the maximum allowable CDCTC for out-of-pocket child care expenses, regardless of DCAP contribution.

In their current form, these policies miss key opportunities to help families and support businesses. **Congress should take steps to expand and better align these tax provisions for working families and businesses to improve access to quality, affordable child care.[3]**

1. Child Care Aware of America, "Catalyzing Growth: Using Data to Change Child Care" Available at https://www.childcareaware.org/catalyzing-growth-using-data-to-change-child-care/#ChildCareAffordability
2. CRS, "The 45F Tax Credit for Employer-Provided Child Care" Available at https://crsreports.congress.gov/product/pdf/IF/IF12379
3. FFYF Letter. Available at https://bit.ly/2023TaxCredits