STRENGTHENING CHILD CARE TAX INCENTIVES TO SUPPORT WORKING FAMILIES

FIRST FIVE YEARS FUND

Understanding the Difference Between the Child and Dependent Care Tax Credit (CDCTC) and the Child Tax Credit (CTC) — and Why Families Rely On Both

Child care is not a luxury for American families – it's a necessity. Yet the high costs associated with quality child care are rapidly out-pacing most other expenses faced by families, including the cost of housing and higher education. This is simply untenable for many families. According to Child Care Aware of America, the national annual average price of child care in 2022 was $10,853 per year, which represents 10% of a two-income family's earnings and 22% of a single parent's earnings, on average. Child care is also difficult to find for many families. Even if a family is eligible for child care assistance, many are unable to secure the care they need. The federal Child Care and Development Block Grant (CCDBG), which provides funding to states to help low-income working families access child care, reaches less than 15% of eligible children. This pervasive lack of access to affordable, quality child care impacts the economic security of our nation's families.

The U.S. has traditionally used the tax code to help address real-world challenges and to incentivize behaviors that result in tremendous economic success for our country. In the same way that tax credits are used to make retirement and higher education more accessible, the tax code should reflect that child care expenses are typically linked to a parent's ability to work and account for one of the most significant expenses in a family's budget.

There are two federal tax credits that aim to support families with young children. The Child and Dependent Care Tax Credit (CDCTC) is targeted to help working families offset the cost of child care, while the Child Tax Credit (CTC) supports families in managing the high costs of raising a child, and is most often used to cover everyday household expenses.[1] Enhancing both of these credits would have a real impact on the economic stability of families, leading to long-term benefits for young children and families.

What is the Child and Dependent Care Tax Credit (CDCTC)?

The CDCTC is the only tax credit that directly helps working parents offset the cost of child care. The CDCTC allows taxpayers to decrease expenses for child care (children under the age of 13) and adult dependents by claiming the credit on their annual income taxes. The credit a family receives is calculated by multiplying the amount of expenses by the family's adjusted gross income (AGI).[2]

The maximum amount of child or dependent care expenses a taxpayer can claim on their taxes is $3,000 for one dependent and $6,000 for two or more. The lowest income taxpayers (families with an AGI of $15,000 or less) receive 35% of those expenses in the form of a credit. A maximum credit available to families at this income level is $1,050 (35% of $3,000 in expenses) for one dependent and $2,100 (35% of $6,000 in expenses) for two or more dependents. The credit rate phases down as income increases until it reaches 20% for families with an AGI of over $43,000, meaning the maximum credit rate available to families at this income level is $600 for one dependent or $1,200 for two or more dependents (20% of $6,000 in expenses).

However, families may claim less than the maximum amount of expenses, and as a result, receive a smaller credit amount. Additionally, if a taxpayer's employer contributes to their care expenses, through a dependent care flexible spending account, or if they take advantage of an employer-sponsored care facility, they may need to subtract the amount contributed to those benefits from their total qualifying expenses.

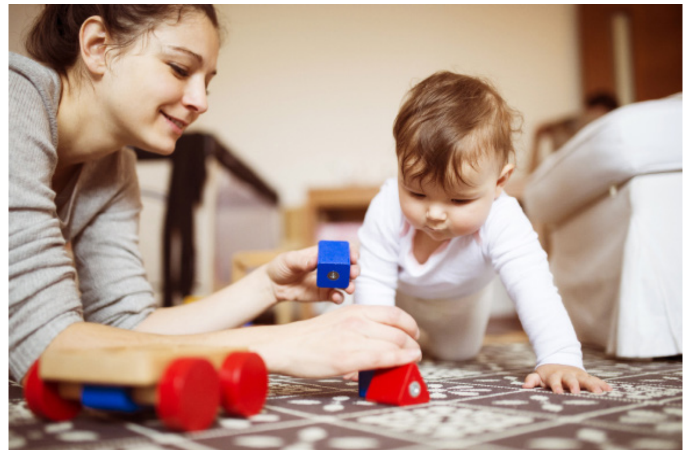
Prior to 2021, the CDCTC had not been amended since 2001 and was not adjusted for inflation. For tax year 2021, COVID-19 relief legislation temporarily made the CDCTC refundable and increased the maximum credit rate, the phaseout threshold, and the amount of eligible expenses, providing meaningful support to working families. However, the CDCTC has since reverted to prior levels.

What is the Child Tax Credit (CTC)?

The CTC helps qualifying parents with children under age 17 offset any costs associated with raising a child. According to recent data, the most common ways parents use the CTC is to pay for basic needs including food, utilities, rent, and clothing. For tax year 2023, the CTC was $2,000 per qualifying dependent child if one's modified adjusted gross income (MAGI)[3] is $400,000 or below (married filing jointly) or $200,000 or below (all other filers).

The CTC is "nonrefundable," meaning if the value of the credit exceeds the amount owed, any balance is forfeited and not paid to the family. Families who want to keep the unused portion of the CTC may be able to claim the refundable portion, also known as the Additional Child Tax Credit. In 2023, the Additional Child Tax Credit was worth up to $1,600.

The CTC was temporarily made more generous under the American Rescue Plan to respond to families' needs during the height of the COVID-19 pandemic. In 2021, the maximum annual payment increased from $2,000 per child to $3,000 per child for children ages 6 to 17 years and $3,600 per child for children ages 0 to 5 years. The credit was also made fully refundable, and families were able to receive up to half of their full credit in monthly installments. According to the United States Census Bureau, the temporary expansion of the CTC helped reduce child poverty to a record low of 5.2% in 2021.



Why do we Need an Expanded Child and Dependent Care Tax Credit (CDCTC)?

The CDCTC has not been amended in two decades and is not indexed for inflation, so even as child care expenses have risen sharply, the credit has not changed to meet these increasing costs. Consequently, the maximum credit covers only about 10% of the average annual cost of care for two children.

Additionally, most low-income families are unable to access the credit. The CDCTC is "nonrefundable," which means it only offsets up to the amount owed in income tax. If the value of the credit exceeds the amount owed, any balance is forfeited and not paid to the family. As a result, most low-income families with $0 tax burden and some middle-income tax-paying families with qualified expenses do not benefit from the credit. According to the Bipartisan Policy Center, fewer than 1% of all taxpayers with incomes under $15,000 even claim the CDCTC, compared to almost 30% of those with incomes between $100,000 and $200,000. Only 12% of taxpayers with children receive a benefit from the credit, according to the most recent data from the Tax Policy Center.

By making the CDCTC fully refundable (which enables low-income families to receive the full benefit), increasing the credit amount for the lowest-earning families, and indexing the maximum credit for eligible expenses to inflation, Congress can support families who can least afford quality child care.

Couldn't we Eliminate the CDCTC and Increase the Child Tax Credit (CTC)?

The CTC plays an essential role in helping families manage the costs associated with raising children and lifting families out of poverty.[4] The CTC is available to parents for each qualifying dependent child under the age of 17 and reflects that families with children have more expenses and less disposable income than those making the same amount without children. Parents can use this credit for any expense.

In contrast, the CDCTC specifically offsets the cost of child care, which parents must have to go to work. Just as businesses deduct the costs of earning the income on which they pay tax, working parents pay taxes on the wages they earn and should receive tax relief for the child care costs required to earn those wages. The CDCTC offers that assistance to working parents, allowing families to earn much-needed income, strengthen the American labor force, and ensure more children have access to high-quality early learning opportunities.

As parents struggle with the rising cost of basic goods and services including child care, both credits are critical to supporting parent's ability to provide for their family.

Strong Voter Support for the CDCTC and the CTC

According to a 2023 poll from FFYF, voters support making child care more affordable by increasing the CDCTC and the CTC.

Support for Increasing the CDCTC:

TOTAL	GOP	DEM
78%	73%	86%

Support for Increasing the CTC:

TOTAL	GOP	DEM
74%	66%	81%

Learn more about how federal tax provisions support child care for working families here.

References:

1. The Annie E. Casey Foundation, "Most Common Uses of 2021 Child Tax Credit Payments: Food, Utilities, Housing, Clothes"

2. AGI is gross income, minus adjustments to that income for certain types of payments, such as student loan interest, alimony, retirement contributions, or health savings account contributions, an individual has made during the year.

3. MAGI is adjusted gross income (AGI) plus these, if any: untaxed foreign income, non-taxable Social Security benefits, and tax-exempt interest. MAGI doesn't include Supplemental Security Income (SSI) interest. For many people, MAGI is identical or very close to adjusted gross income. If a taxpayer's MAGI exceeds the above limits, their credit gets reduced by $50 for each $1,000 that their income exceeds the threshold.

4. Center on Budget and Policy Priorities "The Child Tax Credit"