DEPENDENT CARE ASSISTANCE PLANS (DCAP)

Millions of American families are struggling to find quality, reliable, affordable child care they can depend on. This is having a devastating impact on our youngest learners, working families, and the health of local economies. Making quality child care more accessible allows and encourages parents to enter or return to the labor force. It also has a real impact on the workforce of the future by supporting the development of skills children need to be successful later in life. Updating provisions of the federal tax code is an important part of any child care solution as it benefits working parents and young children while supporting economic stability across the country.

The costs associated with quality child care are rapidly outpacing other expenses faced by families, including housing and higher education. In recent years child care costs even rose at a rate that outpaced inflation. The average price of child care is $10,853 per year, which represents 10% of household income for a married couple with children and 33% of household income for a single parent. Given these factors, quality child care remains out of reach for many working parents. Dependent Care Assistance Plans (DCAP) are one way[1] the tax code can support working parents' access to child care. There are a handful of tax credits and deductions that support families with children. Among these is DCAP, an employer-sponsored benefit–usually in the form of a flexible spending account (FSA)–that helps working parents cover the cost of child care for children under the age of 13, including programs before school, after school, and during the summer.

HOW DOES DCAP HELP FAMILIES?

Families whose employer participates in DCAP can deduct up to $5,000 per year from their pre-tax gross earnings to pay for dependent care expenses (regardless of the number of children). DCAP reduces parents' overall tax burden and lowers out-of-pocket dependent care costs by allowing the use of tax-free money.

HOW DOES DCAP WORK?

An employee typically enrolls in DCAP during the participating employer's annual open enrollment period. They may enroll mid-year if they experience an approved "life event," such as the birth or adoption of a child, marriage, divorce, or other changes that may impact the need for dependent care.

The employee elects the amount they would like to contribute based on their estimated care expenses. Married parents filing taxes jointly and single parents can contribute a maximum of $5,000 annually ($2,500 for married parents filing separately) to pay for dependent care. Pre-tax funds are deducted directly from parents' paychecks, which reduces their overall taxable income. Once the employee selects the contribution amount, it cannot be changed for the remainder of the year unless they experience a qualifying life event. Employers can also choose to contribute to employees' DCAP, but the combined contributions cannot exceed $5,000.

The employee submits required documentation. Generally, this includes a claim form along with an itemized receipt or provider certification showing that an eligible service was provided. Qualified dependent care expenses for children under the age of 13 include child care, pre-K, summer day camp, before and after school programs, and transportation to and from eligible care.

Throughout the year, the employee can use funds in their DCAP to pay for care. Individuals can elect to either receive reimbursements in one lump sum at the end of the year, or throughout the year. While the plan does include a grace period of 2.5 months following the end of the calendar year, generally unused DCAP funds do not roll over, therefore any unspent funds are forfeited to the employer.

WHAT ARE THE CURRENT LIMITATIONS OF DCAP?

Unfortunately, DCAP is outdated and the maximum contribution is not enough to make a meaningful difference in reducing child care expenses. Additionally, the DCAP maximum contribution hasn't been adjusted since 1986. Low employer participation and the inability to benefit from CDCTC and DCAP simultaneously severely limit the number of families who can benefit.

The Maximum Deduction is Too Low

The maximum family contribution is $5,000 per year. Unlike health care FSA's, DCAP contribution limits are not indexed for inflation and have been at this level for over 35 years, despite the rapidly growing costs of child care. The current deduction is not sufficient to offset the annual cost of child care, which averaged $10,853 in 2022[2]. Additionally, the limit does not increase if families have multiple children. While Congress temporarily increased the amount that employees could set aside to $10,500 under the American Rescue Plan Act of 2021, these limits have now reverted back to prior levels.

The Number of Families Participating in DCAP is Limited

Few parents benefit from DCAP, as only those with sponsoring employers are eligible to participate. Bureau of Labor Statistics data indicate that only 43% of civilian workers had access to dependent care FSAs in 2021.[3] The number of employees who actually took advantage of those benefits is likely much lower. Employees with access to DCAP are generally higher-compensated employees at larger companies. Even so, often employees cannot afford to set aside money from their paychecks, making participation difficult. For these reasons, DCAP is unlikely to reach the parents who need the most support accessing and affording child care.

Taxpayers Can't Claim Both DCAP and the CDCTC

As the provisions are currently written, parents who contribute the maximum to their DCAP are unable to also claim the Child and Dependent Care Tax Credit (CDCTC) for additional out-of-pocket expenses.[4] The CDCTC is the only tax credit dedicated specifically to helping working parents offset the cost of child care. Contributing to a DCAP decreases dollar-for-dollar the maximum eligible expenses a parent can claim with the CDCTC. The inability to couple DCAP and CDCTC makes it more difficult for families to afford care, as the average cost of child care is far greater than both the contribution limits for DCAP and credit rates under the CDCTC.

WHAT CAN CONGRESS DO?

Congress should take steps to reform DCAP to better meet the needs of working families, including:

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

[1] FFYF, "Federal Tax Provisions That Support Child Care"

[2] Child Care Aware of America, "Catalyzing Growth: Using Data to Change Child Care"

[3] U.S. Bureau of Labor Statistics, "Employee Benefits"

[4] FFYF, "Child and Dependent Care Tax Credit"

[5] FFYF, "____"

[6] FFYF, "Federal Tax Provisions That Support Child Care"

BIPARTISAN SUPPORT

There has been bipartisan support for DCAP over the past few years. Click here to learn more about recently introduced bills that improve DCAP.[5]

DCAP is one of a few tax provisions that specifically address the cost and accessibility of child care. Click here to learn more about two other tax credits that uniquely support child care–the Child and Dependent Care Tax Credit (CDCTC) and the Employer-Provided Child Care Credit (45F)–and why all three are necessary to support our nation's youngest learners, parents, employers, and the economy at large.[6]