



MARYLAND

FAMILY POLICY IMPACT SEMINAR

The Child and Dependent Care Tax Credit as a Fiscal Resource for Low-Income Families' Payment for Child Care

The Child and Dependent Care Tax Credit (CDCTC) is a federal program designed to facilitate the employment of persons with dependents. This policy brief outlines the effect of the CDCTC on families with diverse incomes, revealing inequitable benefits favoring higher income families. Despite nominal targeting of this credit to low-income families, such families were found to rarely claim the credit. A discussion of barriers to, and limitations of, the credit for low-income families is provided. Recommendations to improve the CDCTC are offered.

Background

Child care is an issue of national significance due to the steady rise of women in the labor force, combined with the growth of single parenthood. According to the U.S. Bureau of Labor Statistics (2004), among families with children under the age of six both parents worked in 53% of two-parent families, 64% of single mothers worked and 85% of single fathers worked.

With respect to costs, a high percentage of family income is spent on child care, especially for low-income families and for those where parents have low educational achievement.¹ For families with employed mothers and children under age five, the U.S. Census Bureau (2005) reports that those at less than 100% of the poverty threshold paid 33.95% of their monthly income on child care. In contrast, higher income families, despite spending more than the national average on child care, allocate a much smaller percentage of their income for the service (6.6%).

Description of the CDCTC

The CDCTC is a non-refundable tax credit that covers a portion of one's employment-related child and dependent care expenses. Expenses are allowable for the care of children under thirteen and dependents of any age that are physically or mentally incapable of

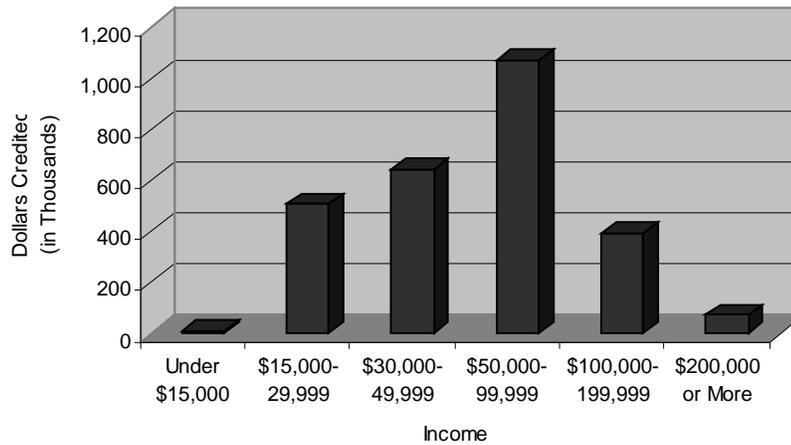
caring for themselves. The amount a family can claim with the CDCTC is delimited in four ways. First, the total amount of allowable expenses a family can claim is limited. Currently, the expense limit is \$3,000 for families with one child in care and \$6,000 for families with two or more children in care. Second, the amount a family claims cannot exceed the earned income of the lower earning taxpayer/spouse. Third, because the tax credit is not refundable, a family cannot benefit from the tax credit in excess of the amount they owe in federal income taxes. Finally, the credit is graduated on a sliding scale ranging from 20% of allowable child care expenses for higher-income taxpayers to 35% for low-income taxpayers.

The CDCTC is designed to have differential impacts on families depending on the family's income level, with the maximum benefit targeted to the lowest income group of families (annual income of \$15,000 or less) and declining proportionally for families with higher incomes. Despite the CDCTC being designed to maximize benefits for the lowest income families, in reality, the opposite is often true. As this credit is non-refundable, the only families who can fully realize the benefit of the credit are those with tax liability equal to, or greater than, the value of the credit. Thus, only moderate- and high-income families can obtain the full CDCTC for which they are eligible.

Effects of the Child and Dependent Care Tax Credit

Eligible low-income families have historically underutilized child and dependent care tax benefits.² Consistent with these patterns, the CDCTC is used predominantly by middle- and upper-income families. Data from the IRS on tax credits filed in 2002 reveal that the majority of persons claiming the CDCTC (57.1%) and the majority of the country's revenue paid out by the credit (54%) goes to families with combined incomes of \$50,000 or more-- families to whom the tax credit is not nominally targeted.³

Figure 1. Dollar Amounts Paid Out by Child and Dependent Care Tax Credit, 2002



Source. U.S. Internal Revenue Service [IRS]. (2004). Table 2. 2002, Individual Income Tax, All Returns: Tax Liability, Tax Credits, and Tax Payments, by size of adjusted gross income. Retrieved February 23, 2005, from <http://www.irs.gov/pub/irs-soi/02in02ar.xls>

Families with incomes under \$15,000, the group to whom this program is nominally targeted, filed only 1.4% of CDCTCs and received only 0.4% of the dollars paid out by this program in 2002.³ (See Figure 1 for breakdown by income categories.)

Although it is impossible to determine the exact number of credits and percentage of CDCTC dollars going to families in the bottom and top 10% income brackets (defined in 2002 as \$5,392 and \$92,663, respectively) due to limitations in available data, estimates using the categories of \$5,000 or less and \$100,000 or more are possible.³ Using these categories, of the dollars paid out by the CDCTC in 2002, less than 1% went to taxpayers in the bottom decile income bracket and more than 17% went to taxpayers in the top decile bracket.

Barriers to Claiming the Child and Dependent Care Tax Credit Among Families Paying for Care

- **Administrative procedures among informal child care providers.** Low-income families predominately use informal care providers (e.g., relatives and friends). Such providers' fears of tax audits may serve as one barrier to parents filing for the CDCTC.
- **Identification security issues among informal providers.** Informal providers without a tax identification number must provide parents applying for the CDCTC with their social security number. Concerns about

identity theft may, thus, serve as a barrier.

- **Lack of knowledge for navigating the tax system.** While middle- and upper-income individuals are often socialized by their peers regarding the value of tax breaks and how to claim tax benefits, there is evidence to suggest that many low-income individuals do not know they are eligible for tax benefits such as the CDCTC.

Limitations of the CDCTC

- **Non-refundable credit.** Many low-income families do not fully benefit from the tax credit because they lack sufficient tax liability to claim the credit.
- **Insufficient allowable child care expenses.** In 2003, the average cost of child care for one child was \$303 per month or \$3,636 per year.⁴ Child care costs are greater for higher quality care, and care for infants. The CDCTC only allows expenses up to \$3,000 for one child and \$6,000 for two or more children.

Recommendations for Improving the CDCTC

- Make the CDCTC refundable.
- Raise the allowable expenses for child care.
- Index all aspects of the program to inflation.⁵
- Enhance education and outreach efforts.

¹ Brayfield, A., & Hofferth, S. (1995). Balancing the family budget: Differences in child care expenditures by

race/ethnicity, economic status, and family structure. *Social Science Quarterly*, 76(1), 158-177.

² Blau, D. M. (2001). *The child care problem: An economic analysis*. New York: Russell Sage.

³ U.S. Internal Revenue Service. (2004). *Table 2.--2002, Individual Income Tax, all returns: Tax liability, tax credits, and tax payments, by size of adjusted gross income*. Retrieved February 25, 2005, from

<http://www.irs.gov/pub/irs-soi/02in02ar.xls>

⁴ Giannarelli, L., Adelman, S., & Schmidt, S. (2003). *Getting help with child care expenses. Occasional Paper Number 62*. Washington, DC: The Urban Institute.

⁵ National Women's Law Center. (2003). *Indexing the DCTC is necessary to prevent further erosion of the credit's value to low-income families*. Retrieved September 23, 2004, from

<http://www.nwlc.org/pdf/IndexingDCTCFactSheet2003.pdf>

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Citation for brief:

Forry, N. D. (2006). *The Child and Dependent Care Tax Credit as a Fiscal Resource for Low-Income Families' Paying for Child Care*. Research brief. University of Maryland. Retrieved [insert date and http address].

This policy brief is excerpted from the following article:

Forry, N. D. & Anderson, E. A. (in press). The child and dependent care tax credit: A policy analysis. *Marriage and Family Review*, 39(1-2), 159-176.