First Five Years Fund

Tax Proposals that Support Working Families

How to Increase Access to High-Quality Early Childhood Education

December 2016

High-quality early learning and care programs are rapidly out-pacing other expenses faced by families, including the cost of higher education. Quality early childhood education supports better health, social, and economic outcomes in life - increasing productivity and reducing the need for expensive social spending in other areas later in life. While the tax code includes numerous provisions to help families offset higher education costs, very few incentives exist to offset early childhood education expenses.

Changing this dynamic is crucial, not just for the wellbeing of today's children, but for the economic health of our country. Less than half of low-income children have access to high-quality early childhood programs that could dramatically improve their opportunities for a better future. This statistic is tragic when one considers that skills developed in the first five years greatly influence success later in life. Expanding availability and options for parents to access high-quality early childhood programs now, results in reduced costs to society later.

As Congress considers comprehensive tax reforms, there is a significant opportunity to expand access to early childhood education by enhancing existing tax credits and deductions for families, and by adding new and innovative strategies to encourage investment in high quality programs.

The following proposals offered by the First Five Years Fund (FFYF) are similar to the proposals put forth by President-elect Trump, with a few small modifications. Mainly, we recommend using existing tax credits rather than creating a new deduction. Also, our Dependent Care Assistance Program (DCAP) proposal includes higher limits and incentivizes employers to contribute more to employee accounts. However, FFYF would be supportive of President-elect Trump's plan allowing accounts to be held by individuals and allowing those funds to roll-over for use in future years.

Make the Child and Dependent Care Tax Credit (CDCTC) refundable for children under 5 years old.

Under current law, CDCTC provides a non-refundable tax credit of 20-35 percent of the first $3,000 spent on care for one child and the first $6,000 on care for two or more children (the value of the credit decreases as income increases). If the credit was refundable for children under 5:

- Current law would be brought up-to-par with actual costs for non-school aged children.
- The credit would be expanded to additional low-income individuals who are not currently able to benefit from the credit due to limited tax liability.

Enhance the American Opportunity Tax Credit (AOTC), and allow it to be used for quality education programs for children under the age of five.

The AOTC is a $2,500 credit per student for costs related to post-secondary expenses, including tuition, fees, books, and supplies - up to $1,000 is refundable for low-income tax-payers. Expanding the AOTC to include expenses for early childhood education would:

- Give parents a new tool to pay for quality programs.
- Provide more parity in the tax code between higher education and education for non-school-aged children.

Expand the definition of "qualified institutions" for tax free scholarships.

Under current law, virtually all scholarships and tuition assistance programs are tax free, as long as the assistance is used for attendance at a "qualified institution", generally defined as a primary, secondary, post-secondary or vocational. Expanding the definition of qualified institutions for tax free scholarships to include high-quality programs for children ages 0-5 would:

- Allow tax free scholarships, tuition reduction, and assistance for early childhood learning programs.
- Incentivize scholarship opportunities for early learning and promote community philanthropy.

Increase limits on the Dependent Care Assistance Program (DCAP) and incentivize employers to contribute more to employee accounts.

The DCAP is an employer-sponsored program that provides reimbursements for up to $2,500 annually ($5,000 for married couples) to employees who pay for dependent care - employees are then allowed to deduct these dependent care expenses from their paycheck on a pre-tax basis. Access to DCAPs has remained relatively unchanged over the last five years; however, low-wage employees and service industry workers have significantly lower access.

According to the Bureau of Labor Statistics National Compensation Survey (2014), 58% of professional and managerial workers have access to DCAP plans. In contrast, only 18% of service industry workers have similar plans. For low-wage workers, the number drops to 16%.

- Current limits have failed to keep up with the rising costs of child care - increasing DCAP limits to $10,500 and indexing those limits to inflation would ensure that these plans effectively cover costs for families.
- Providing tax credits for startup costs, similar to incentives for small business pension plans, would incentivize businesses to establish DCAP benefits – affording additional credits for employers who match employee contributions would encourage businesses to provide more generous benefits.