First Five Years Fund

TAX REFORM SHOULD STRENGTHEN EXISTING CHILD CARE INCENTIVES

Child care is not a luxury for American families—it's a necessity.

Yet the costs associated with quality child care are rapidly outpacing other expenses faced by families, including the cost of higher education.

As Congress and the administration consider comprehensive tax reforms, there is a significant opportunity to update the tax code so that existing incentives reflect the modern cost of child care, and to add new and innovative strategies that encourage investment in high-quality care.

The overwhelming research shows increasing access to a high-quality early childhood education is one of the most effective investments for American families and communities, generating outcomes that are proven to set children up to succeed in school and become productive adults later in life.

While there are a handful of tax credits and deductions that support families with children, only the Child and Dependent Care Tax Credit (CDCTC) was designed to help working parents with the cost of work-related child care expenses. Unfortunately, the CDCTC is outdated and can't meet the current needs of working families. Congress can change that.

Read more about the importance of maintaining the CDCTC, expanding it, and making it refundable to reach the families who need it most.

What is the Child and Dependent Care Tax Credit?

The Child and Dependent Care Tax Credit (CDCTC) was created in 1976 to help working parents with work-related child care expenses. Congress approved a temporary increase to the credit in 2001, and in 2012 a bipartisan majority voted to make that expansion permanent.

Today, the credit varies between 20 and 35 percent of qualified expenses up to $3,000 per eligible child. Qualified expenses are capped at $6,000. That means the maximum credit for working parents with two or more children is $2,100, or only about 10 percent of the average annual cost of care for two children in the United States.

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Currently, the credit is not refundable. As a result, most low- and some middle-income, tax-paying families with qualified expenses are unable to take advantage of the credit. Therefore, higher-income families benefit most from the tax credit. The Tax Policy Center found that nearly 40 percent of the credit's value is claimed by families earning $100,000 or more, while almost no families in the bottom income quintile were able to access the credit.

The credit's expense limits are also not indexed for inflation, so even as child care expenses have risen sharply since 2001, the value of the CDCTC has remained frozen in place.

To help the CDCTC better fulfill its role and help working parents of modest means afford the cost of child care, tax reform should 1) maintain this critical credit amidst efforts by some whose primary goal is to flatten the code, 2) increase the value of the CDCTC sharply, and 3) make the CDCTC refundable, so low- and middle-income families can benefit.

Why do we need an expanded Child and Dependent Care Tax Credit?

Nearly 15 million children in America under the age of six have working parents. For many of these families, paying for child care presents a significant and growing burden that impedes their ability to enter, return, or remain in the workforce. If safe, quality child care is cost-prohibitive or not available, returning to work is often not an option. This denies families the chance to earn much-needed income, and it weakens the American labor force. Employee absenteeism due to child care issues contributes to a loss of $3 billion for U.S. businesses annually.

We know that early childhood education for children from birth through age five results in positive economic returns for families and society. However, as a nation, we're struggling with high costs and shortages of quality care providers. Making the CDCTC a more robust tax incentive for quality care will help to improve the situation by making care more affordable while incentivizing growth and expansion in the early education sector, resulting in increased access.

The U.S. has traditionally used the tax code to address real-world problems many Americans face, and to incentivize behaviors that result in overall economic benefits. For example, we incentivize people to save for retirement through deductions and exclusions in the tax code. We also use the tax code to encourage homeownership and college education. Over time, these incentives have helped to make college attendance and homeownership possible for more Americans.

As a nation, we're struggling with high costs and shortages of quality child care providers. In the same vein that we use tax credits to make higher education more accessible, the tax code should also make care for children from birth through age five a priority. A robust child care tax incentive will help to change that dynamic by making care more affordable for parents and incentivizing growth and expansion in the early childhood education sector, resulting in increased access and improved care.

Wouldn't we be better off just increasing the Child Tax Credit?

The Child Tax Credit (CTC) is a tax credit targeted at families with dependent children and is designed to ensure that the tax code reflects the fact that families have more expenses and less disposable income than individuals and couples with the same income who don't have children.

While the CTC performs an important function, it is not targeted at working parents and it is not tied to the child's care. Parents may use the CTC money for any expense, even those not related to the costs of raising their children.

The tax code should provide broad support for all families of limited means, but not at the expense of provisions directed specifically at child care and early childhood education, which are proven to have significant, lasting benefits for both the children who benefit, as well as society at large. Rising child care costs present a very specific challenge that demands a specific response.

As Congress pursues comprehensive tax reform, maintaining and expanding the Child and Dependent Care Tax Credit must be a priority.