CHILD AND DEPENDENT CARE TAX CREDIT (CDCTC)

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.[1] Given these factors, quality child care remains out of reach for many working parents. There are a handful of tax credits[2] and deductions that support families with children. The Child and Dependent Care Tax Credit (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 and keep more of what they earn.

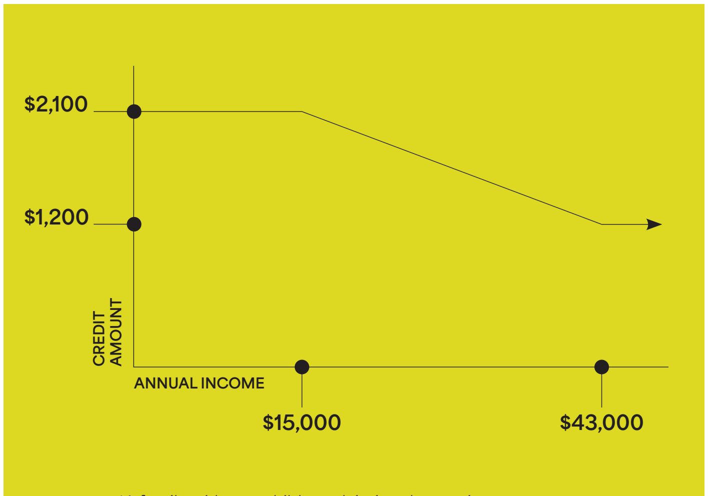
HOW DOES THE CDCTC HELP FAMILIES?

The CDCTC is based on a combination of income level and the amount paid for child care while working, looking for work, or going to school. Families can benefit from the CDCTC if they meet the minimum income to file a tax return. Taxpayers can decrease expenses for child care (children under the age of 13) and adult dependents[3] by claiming the credit on their annual income taxes.

HOW DOES IT WORK?

The maximum amount of child or dependent care expenses a taxpayer can claim is $3,000 for one dependent and $6,000 for two or more. The lowest-income taxpayers (with incomes under $15,000) receive 35% of those expenses as a credit (35% of $3,000 is $1,050 for one dependent). This phases down as income increases until it reaches 20% for taxpayers with incomes above $43,000 (20% of $3,000 is $600 for one dependent). **The credit helps families pay for child care by reducing their taxable income by a maximum of $1,050 for one dependent and $2,100 for two or more dependents.**

CDCTC CREDIT RATE*



A family with two children claiming the maximum expenses

But how it actually looks in practice might be surprising. With the average price of child care at $10,853 per year[4], this credit doesn't amount to much for most families. In reality, because most families do not file for the maximum amount of expenses, families with incomes under $15,000 receive a credit of only $124 on average, while those with incomes over $25,000 receive between $500 and $600.

TEMPORARY EXPANSION UNDER PANDEMIC RELIEF

For tax year 2021, the American Rescue Plan (ARP) COVID-19 relief legislation temporarily expanded the CDCTC to reach more families in need by:

- Making it fully refundable,
- Increasing the credit rate to 50% for families with incomes less than or equal to $125k,
- Extending the 20% credit rate to families with incomes between $183k and $400k, and
- Increasing the amount of eligible expenses to $8,000 for one dependent and $16,000 for two or more.

The expanded CDCTC saw a notable increase in 2022, with 288,000 more families benefiting compared to the pre-ARP expansions in 2020.[6] However, the CDCTC has since reverted to prior levels.

WHAT ARE THE CURRENT LIMITATIONS OF CDCTC?

Unfortunately, the CDCTC is outdated and is not available to the families who are most in need. The CDCTC has not been permanently adjusted in two decades and is not indexed for inflation, so even as child care expenses have increased, the credit has not evolved to meet these rising costs. Current limitations of the CDCTC include:

Most low-income families are unable to access the credit.
The credit is nonrefundable, which means the CDCTC can only reduce a tax bill to zero (and not provide the difference as a refund). As a result, 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 Tax Policy Center, only 12% of families with children benefited from the credit under pre-ARP rules.[7] Fewer than 1% of all taxpayers with incomes under $15,000 claim the CDCTC, compared to almost 30% of those with incomes between $100,000 - $200,000.

Even when families claim the credit, the amount they receive does little to offset the actual cost of care.
Since 1990, child care costs have risen 214%, far outpacing the 143% increase in average family income.[8] Because the CDCTC lacks any inflation adjustment, it has not kept pace with the escalating child care costs, meaning families aren't getting as much help from the credit as they used to. In its current form, the credit barely helps to offset the actual price of child care. The most a parent with one child can receive is $1,050–around one-tenth of the average annual cost of child care ($10,583).[9] The credit has no upper-income limit, therefore the CDCTC is being stretched and not currently benefiting those most in need.

WHAT CAN CONGRESS DO?

By expanding and updating the CDCTC, policymakers have an opportunity to help address working families' child care needs. To help the CDCTC better fulfill its role and help working parents afford child care, Congress should:

- Make the CDCTC fully refundable, enabling low-income families to receive the full benefit.
- Increase the credit rate for the lowest-earning families.
- Index the maximum credit for eligible expenses to inflation.

BIPARTISAN SUPPORT

There has been bipartisan support for the CDCTC over the past few years. Click here to learn more about recently introduced bills that improve the CDCTC.[10]

CDCTC 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 Employer-Provided Child Care Credit (45F) and the Dependent Care Assistance Program (DCAP)–and why all three are necessary to support our nation's youngest learners, their parents, employers, and the economy at large.[11]

[1] Child Care Aware of America, "Annual Child Care Landscape Analysis"

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

[3] An adult dependent is a person who isn't mentally or physically able to care for himself or herself and lives with the taxpayer for more than half the year

[4] Child Care Aware of America, "Annual Child Care Landscape Analysis"

[5] Congressional Research Services, "Child and Dependent Care Tax Benefits: How They Work and Who Receives Them"

[6] U.S. Congress, Joint Committee on Taxation, "Estimates of Federal Tax Expenditures For Fiscal Years 2020-2024" and U.S. Congress, Joint Committee on Taxation, "Estimates of Federal Tax Expenditures For Fiscal Years 2022-2026"

[7] Tax Policy Center, "Key Elements of the U.S. Tax System"

[8] FFYF, "The First Five Things To Know About: Federal Funding for Early Learning and Child Care"

[9] Child Care Aware of America, "Annual Child Care Landscape Analysis"

[10] FFYF, "New Polling on Child Care and the 2024 Election"

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