FIRST FIVE YEARS FUND

The Child Tax Credit and the Child & Dependent Care Tax Credit

UNDERSTANDING THE DIFFERENCE

OVERVIEW

- The **Child and Dependent Care Tax Credit (CDCTC)** specifically helps working parents offset the cost of child care and puts parents in the driver's seat to help ensure families can choose the type of care that works best for them.
- The **Child Tax Credit (CTC)** can be used by families to offset any costs associated with raising a child, like food, rent, clothes, medicine, diapers, etc. It plays an essential role in helping to lift families out of poverty.
- The current CDCTC benefit levels were **set in 2001**; they have not been adjusted to keep pace with inflation or the current cost of care.
- As parents struggle with the rising cost of basic goods and services including child care, **both credits are essential**. Together they support parents' ability to provide for their family and create paths to prosperity for current and future generations.

The Child and Dependent Tax Credit and The Child Tax Credit support families in very different ways. **Families need both.**

Child care is not a luxury for American families - it's a necessity. Yet the high costs associated with quality child care are rapidly outpacing most other expenses, including the cost of housing and higher education. This is simply untenable for many families. According to Child Care Aware of America, the national annual average price of child care in 2023 was $11,582 per year. And beyond cost, many parents struggle to find care that meets their unique needs, including availability, flexibility, work hours, and other preferences.

This pervasive lack of access to affordable, quality child care options impacts the economic security of our nation's families.

The U.S. has traditionally used the tax code to help address real-world challenges and to incentivize behaviors that result in tremendous economic success for our country. In the same way that tax credits are used to make retirement and home buying more accessible, the tax code should reflect that child care expenses are typically linked to a parent's ability to work and account for one of the most significant expenses in a family's budget.

There are two federal tax credits that aim to support families with young children.

The Child and Dependent Care Tax Credit (CDCTC) is targeted at helping working families offset the cost of child care at the provider of their choice. The Child Tax Credit (CTC) supports families in managing the high costs of raising a child, and is most often used to cover everyday household expenses.[1]

Enhancing both of these credits would have a real impact on the economic stability of families, leading to long-term benefits for young children and families.

WHAT IS THE CHILD AND DEPENDENT CARE TAX CREDIT (CDCTC)?

The CDCTC is the only tax credit that directly helps working parents offset the cost of child care. It also fosters parental choice, with parents able to claim the type of care that best fits their family's individual needs, whether it be center-based care, faith-based care, or an in-home child care provider.

The CDCTC allows taxpayers to decrease expenses for child care (children under the age of 13) and adult dependents by claiming the credit on their annual income taxes. The credit a family receives is calculated by multiplying the amount of expenses by the appropriate credit rate.

ENHANCING THE CTC & CDCTC

	$11,582	Average annual cost of child care in 2023
CDCTC	**$587**	Current average benefit
CDCTC	**$2,099**	Temporarily expanded benefit (tax year 2021)
CTC	**$2,000**	Current average benefit (for a child age 5 and under)
CTC	**$3,600**	Temporarily expanded benefit (tax year 2021)

HOW DO FAMILIES USE THE CTC & CDCTC?

CDCTC

The CDCTC is a tax credit specific to child care expenses.

- **100% of parents who claim the credit use it to offset child care costs.**

CTC

The CTC can be used to defray any costs associated with raising a child. When the CTC was temporarily increased in 2021:

- **Only 16% of parents who claimed the credit used it to offset child care costs.**

Parents also used the tax credit for other essentials including:

- Food (52%)
- Utilities (52%)
- Rent/Mortgage (45%)
- Clothes (44%)
- Education costs (40%)
- Vehicle Payments (19%)
- Debts (19%)
- Child Care (16%)

Source: Center on Budget and Policy Priorities analysis of U.S. Census Bureau Data

The maximum amount of child or dependent care expenses a taxpayer can claim on their taxes is $3,000 for one dependent and $6,000 for two or more. The credit rate phases down as incomes rise.

Lowest income taxpayers (families with an adjusted gross income - or AGI[2] - of $15,000 or less): 35% of expenses in the form of a credit (or $1,050 for one dependent and $2,100 for two or more.)

Highest income taxpayers (families with an AGI of $43,000 or more): 20% of expenses in the form of a credit (or $600 for one dependent and $1,200 for two or more.)

However, families may claim less than the maximum amount of expenses, and as a result, receive a smaller credit amount. Additionally, if a taxpayer's employer contributes to their care expenses, through a dependent care flexible spending account, or if they take advantage of an employer-sponsored care facility, they may need to subtract the amount contributed to those benefits from their total qualifying expenses. On average, families receive less than $600.[3]

Prior to 2021, the CDCTC had not been amended since 2001 and was not adjusted for inflation. For tax year 2021, COVID-19 relief legislation temporarily made the CDCTC refundable and increased the maximum credit rate, the phaseout threshold, and the amount of eligible expenses, providing meaningful support to working families by increasing the average credit to over $2,000. However, the CDCTC has since reverted to prior levels.

WHAT IS THE CHILD TAX CREDIT (CTC)?

The CTC helps qualifying parents with children under age 17 offset any costs associated with raising a child. For tax year 2023, the CTC was $2,000 per qualifying dependent child if one's modified adjusted gross income (MAGI)[4] is $400,000 or below (married filing jointly) or $200,000 or below (all other filers).

The CTC is "nonrefundable," meaning if the value of the credit exceeds the amount owed, any balance is forfeited and not paid to the family. The CTC was temporarily expanded for a single year (tax year 2021) under the American Rescue Plan. As a result, in 2021, the maximum annual payment increased from $2,000 per child to $3,000 per child for children ages 6 to 17 years and $3,600 per child for children ages 0 through 5 years. The credit was also made fully refundable, and families were able to receive up to half of their full credit in monthly installments. According to the United States Census Bureau, the temporary expansion of the CTC helped reduce child poverty to a record low of 5.2% in 2021.

WHY DO WE NEED AN EXPANDED CHILD AND DEPENDENT CARE TAX CREDIT (CDCTC)?

The CDCTC has not been amended in two decades and is not indexed for inflation, so even as child care expenses have risen sharply, the credit has not changed to meet these increasing costs. Consequently, with the average price of child care at $11,582 per year, the credit often offsets less than one month of care.

Additionally, most low-income families are unable to access the credit. The CDCTC is "nonrefundable," which means it only offsets up to the amount owed in income tax. If the value of the credit exceeds the amount owed, any balance is forfeited and not paid to the family. As a result, most low-income families with $0 tax burden and some middle-income tax-paying families with qualified expenses do not benefit from the credit.

By making the CDCTC fully refundable (which enables low-income families to receive the full benefit), increasing the credit amount for the lowest-earning families, and indexing the maximum credit for eligible expenses to inflation, Congress can support families who can least afford quality child care.

FAMILIES NEED BOTH THE CTC AND THE CDCTC.

Child care is a necessity for working families. There are nearly 15 million children ages 5 and under in the United States who may need care because all their available parents are in the workforce.[5] Parents need quality, affordable options.

The CTC plays an essential role in helping families manage the costs associated with raising children and lifting families out of poverty.[6] The CTC is available to parents for each qualifying dependent child under the age of 17 and reflects that families with children have more expenses and less disposable income than those making the same amount without children. Parents can use this credit for any expense.

In contrast, the CDCTC specifically offsets the cost of child care, which parents must have to go to work. Just as businesses deduct the costs of earning the income on which they pay tax, working parents pay taxes on the wages they earn and should receive tax relief for the child care costs required to earn those wages. The CDCTC offers that assistance to working parents, allowing families to earn much-needed income, strengthen the American labor force, and ensure more children have access to high-quality early learning opportunities.

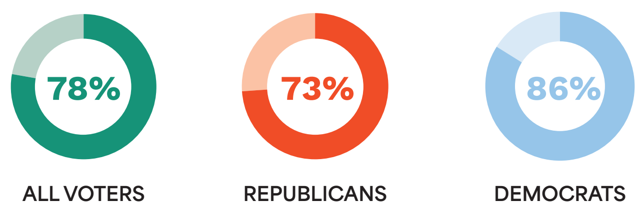
Child care is **not a luxury** for American families – it's **a necessity**.

As parents struggle with the rising cost of basic goods and services including child care, both credits are critical to supporting parent's ability to provide for their family.

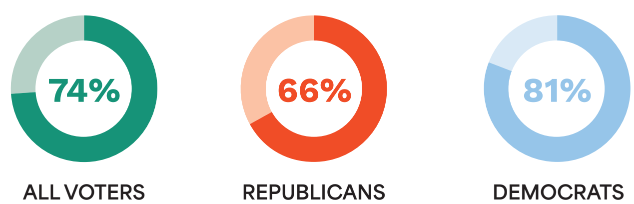
STRONG VOTER SUPPORT FOR THE CDCTC AND THE CTC

According to a 2023 poll from FFYF, voters support making child care more affordable by increasing the CDCTC and the CTC.

SUPPORT FOR INCREASING THE CDCTC



SUPPORT FOR INCREASING THE CTC



ABOUT FIRST FIVE YEARS FUND

The first five years last forever. At First Five Years Fund, we work to protect, prioritize, and build bipartisan support for quality child care and early learning programs at the federal level. Reliable, affordable, and high-quality early learning and child care can be transformative, not only enhancing a child's prospects for a brighter future but also bolstering working parents and fostering economic stability nation-wide. Join us at www.ffyf.org.

[1] The Annie E. Casey Foundation, "Most Common Uses of 2021 Child Tax Credit Payments: Food, Utilities, Housing, Clothes" (2022).

[2] AGI is gross income, minus adjustments to that income for certain types of payments, such as student loan interest, alimony, retirement contributions, or health savings account contributions, an individual has made during the year.

[3] Congressional Research Service, "Child and Dependent Care Tax Benefits: How They Work and Who Receives Them" (2021).

[4] MAGI is adjusted gross income (AGI) plus these, if any: untaxed foreign income, non-taxable Social Security benefits, and tax-exempt interest. MAGI doesn't include Supplemental Security Income (SSI) interest. For many people, MAGI is identical or very close to adjusted gross income. If a taxpayer's MAGI exceeds the above limits, their credit gets reduced by $50 for each $1,000 that their income exceeds the threshold.

[5] U.S. Census Bureau, "2022: ACS 5-Year Estimates, B23008"

[6] Center on Budget and Policy Priorities "The Child Tax Credit"