File: DCTC

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Tax Relief for Employed Families: Improving the Dependent Care Tax Credit

The dependent care tax credit ("DCTC") assists families in meeting the costs of child and adult care by allowing taxpayers to offset a portion of their employment-related dependent care expenses against their federal income tax liability. The DCTC has provided significant federal assistance to millions of families with child and dependent care expenses since its enactment in 1976.
In 1997, the most recent year for which Internal Revenue Service data are available, 5.8 million taxpayers claimed the credit and received over $2.4 billion in tax relief.[1]

Since the credit was last expanded in 1981, however, its value has eroded, particularly for low-income families with employment-related care expenses. The loss in value of tax support for child and dependent care expenses is significant for many families who are struggling to pay for increasingly expensive care for their children and adult dependents.

To provide a framework for evaluating proposals to change the DCTC, this paper examines the current structure of the DCTC, the sound policies the credit serves, and the reasons why the value of the DCTC has eroded. In addition, it suggests several ways in which to strengthen and restore the value of the DCTC for families with employment-related child care expenses.[2]

I. What is the Dependent Care Tax Credit?

The DCTC allows taxpayers who have employment-related[3] expenses for the care of a child under the age of 13, or for the care of a spouse or dependent who is physically or mentally incapable of self-care, to set off a percentage of those expenses against their federal income tax liability. The amount of the credit that may be claimed is determined by the amount of the taxpayer's expenses and the taxpayer's adjusted gross income ("AGI").[4] A credit may be claimed for a percentage of the taxpayer's qualifying expenses up to $2,400 for one child or dependent or $4,800 for two or more children or dependents, with the percentage varying according to the taxpayer's AGI to provide the greatest benefit to low-income taxpayers.[5] Families with AGIs of $10,000 or less are eligible for a credit equal to 30% of their qualifying expenses, while families with AGIs over $28,000 are eligible for a credit equal to 20% of their qualifying expenses.[6] Between $10,000 and $28,000 AGI, the value of the credit decreases as the applicable percentage declines by one percentage point for each $2,000 increase in AGI.[7] **The maximum value of the credit for a family with an AGI of $10,000 or less is $720 for one dependent ($1,440 for two or more dependents), and for a family with an AGI of $28,000 or more is $480 for one dependent ($960 for two or more dependents).**

Dependent Care Tax Credit Amounts

Adjusted Gross Income	Maximum Credit for One Child/Dependent	Maximum Credit for Two or More Children/ Dependents	Adjusted Gross Income	Maximum Credit for One Child/Dependent	Maximum Credit for Two or More Children/ Dependents
$0-$10,000	$720	$1,440	**$20,001-$22,000**	$576	$1,152
$10,001-$12,000	$696	$1,392	**$22,001-$24,000**	$552	$1,104
$12,001-$14,000	$672	$1,344	**$24,001-$26,000**	$528	$1,056
$14,001-$16,000	$648	$1,296	**$26,001-$28,000**	$504	$1,008
$16,001-$18,000	$624	$1,248	**$28,001+**	$480	$960
$18,001-$20,000	$600	$1,200			

The DCTC permits flexibility in care arrangements, covering both in-home and out-of-home care in a variety of settings.[8] However, institutional care, such as that provided by a nursing home, is not covered for adult dependents, and care provided by a dependent care center (defined as a facility which receives payment for its services and provides care for more than six individuals) must meet all applicable state and local laws and regulations, such as licensing requirements, and building and fire code regulations.[9]

The DCTC is not refundable -- that is, a family whose credit is larger than its tax liability is *not* entitled to receive the difference from the Internal Revenue Service as a tax refund. For example, a family that qualifies for a credit of $600 but only owes $400 in taxes will receive a credit of only $400. If the credit were refundable, the family would receive a tax refund of $200. In addition, although the expense limitations of $2,400 and $4,800 once represented average care costs, they do not reflect the cost of care today, have not been raised since 1981, and are not indexed for inflation.

II. Policies Served by the Dependent Care Tax Credit

Several sound policy goals underlie the provisions of the DCTC:

- **Assisting Families with Employment-Related Child and Dependent Care Expenses.** Many families have employment-related child and dependent care expenses that put a severe strain on the family budget. Nationally, child care consumes between 6% and 25% of a family's income, with a larger proportion of a family's income consumed by child care the lower the family income.[10] The most recent data available from the Department of Health and Human Services indicate that the cost of child care today can range from $3,000 to $10,000 annually.[11] Yet about half of families with young children earn less than $40,000 a year,[12] and single mothers with children earn even less -- in 1997, the median income of families with children headed by a woman was $17,256, 40% less than the median income of families with children headed by a man ($28,668) and more than two-thirds less than the median income of married couples with children ($54,395).[13] Employment-related care expenses for adults can also be very high. The average cost of adult day care varied from a low of $16.50 per day in New Hampshire to a high of $54 per day in California in 1995[14] -- $4,290 and $14,040 a year, respectively. Many families simply do not have the financial resources to pay for care of children or adult dependents; as a result, the cost of employment-related care keeps many individuals out of, or limits their participation in, the job market.

- **Targeting Assistance to Low- and Moderate-Income Taxpayers.** The DCTC is targeted to provide the greatest benefit to low- and moderate-income taxpayers by providing a credit of a greater percentage of care expenses to lower-income families than to higher-income families. Targeting the credit this way gives more help to families who are most in need of assistance with employment-related child and dependent care expenses, which consume a large proportion of their income.

- **Promoting Tax Equity.** The credit is available only for child and dependent care expenses that enable the taxpayer to participate in the labor force. An important purpose of the credit is to assure fair treatment in our nation's tax policies between families who have employment-related child and dependent care expenses and families who do not have such expenses. The DCTC reflects a recognition that families with the same income and family size who have employment-related, out-of-pocket child and dependent care expenses have less ability to pay taxes than families with the same income and family size who do not have such expenses. For example, a family that earns $25,000 a year but must spend $3,000 on child care to earn that income has less available income than a family that earns $25,000 and has no employment-related care expenses. The DCTC promotes fairness by providing a credit to partially offset a family's employment-related care expenses, thereby helping to equalize its ability to pay taxes.

- **Providing Tax Support for Both Child and Adult Care Expenses.** The DCTC covers expenses incurred for the care of children as well as of spouses and dependents who are incapable of self-care. This is an important recognition of the fact that many families are responsible for the care of not only their children but also of spouses and dependents other than children, all of whom require care when their caregiver is employed.

III. How the Value of the Dependent Care Tax Credit Has Eroded for Families

Although the DCTC is designed to help all families meet their employment-related care expenses, several circumstances have contributed to diminish the value of the credit for millions of families, particularly low- and moderate-income families. These factors include the credit's lack of refundability and indexing for inflation, and the increasing cost of child care. As a result, fewer and fewer low- and moderate-income families are able to benefit from the credit each year.

- **The DCTC is not refundable.** Families who have no or low federal income tax liability receive no or low benefit from the credit because it is non-refundable -- that is, a family whose credit amount exceeds its federal income liability is not able to receive the difference in the form of a tax refund. The DCTC's non-refundability affects primarily families with more limited incomes -- the very families whose need for assistance with employment-related care expenses is the greatest. For example, in tax year 2000, a married couple with two children filing a joint tax return will have no federal income tax liability if it has an income of $18,550 or less.[15] Likewise, a single parent with one child filing a return for 2000 will have no tax liability if he or she has an income of $12,050 or less[16] -- more than the $10,712 the single parent will earn if he or she has a full-time, minimum-wage job.[17] Without refundability, families below these income levels are unable to benefit from the assistance with employment-related care expenses that the DCTC offers.

- **Over time, fewer and fewer families receive the benefit of the DCTC's low-income targeting because the credit is not refundable and because the sliding scale thresholds are not indexed for inflation.** The tax code's basic provisions that determine individual liability -- the personal exemption, standard deduction, tax brackets, and for low-income taxpayers, the EITC -- are all indexed.[18] Indexing these provisions avoids increasing a family's tax burden when the only change in its adjusted gross income is the result of inflation. In contrast, the amount of AGI at which the DCTC's maximum percentage of qualifying expenses begins to decline is not indexed, and has not been adjusted since 1981.

  Because the basic tax provisions determining individual tax liability are indexed, but the DCTC is not, the amount of income a family may have before incurring any federal income tax liability increases each year, but the income thresholds at which a family may claim the DCTC's highest percentages of qualifying care expenses as a tax credit do not. As a result, each year fewer low-income families have enough federal income tax liability to claim the DCTC's highest percentages of expenses. In addition, because the DCTC is not refundable, families who have no income tax liability as the result of indexed deductions, exemptions and tax brackets are unable to derive any benefit from the DCTC at all.

For example, in 1984, the last year before any of the basic tax code provisions were indexed, both a married couple with two children filing jointly and a single parent with one child would have owed federal income taxes if either had an income of considerably less than $10,000, the income threshold for taking the maximum DCTC of 30% of qualified dependent care expenses.[19] By comparison, for tax year 2000 the tax thresholds for all married couples and heads of household with children are above $10,000, the thresholds for heads of household with two or more children or dependents are above $14,000, and the thresholds for married couples with two or more children or dependents are above $18,000. As these figures illustrate, almost **no** families are eligible for the highest credits of 30-25% of their expenses, since even families with only one or two children or dependents do not pay taxes at the income levels eligible for these percentages.

The combination of the DCTC's lack of indexing and refundability has contributed to a dramatic decline in the number of very low-income families who claim the DCTC, as IRS data demonstrate. In 1984, nearly 7.5 million taxpayers claimed the DCTC, representing 7.5% of all tax filers.[20] Many of those claimants were very low-income families -- 22% of claimants were in the bottom income quintile.[21] Most of the claimants were low- to moderate-income families -- 60% of all 1984 claimants were in the first three income quintiles.[22] Only 9% of families claiming the DCTC in 1984 were in the top income quintile[23]. In 1997, the most recent year for which IRS data are available, 5.8 million taxpayers claimed the DCTC,[24] representing a little over 4.5% of all filers.[25] Although the majority of families claiming the credit in 1997 continued to be low- to moderate-income families -- 53% of all claimants were in the first three income quintiles -- there was a dramatic decrease in the number of very low income families claiming the credit.[26] Only 11% of the 1997 claimants were in the bottom income quintile.[27]

IRS data also demonstrate that low-income families are receiving less and less of the tax assistance that the DCTC offers. Families claiming the DCTC in 1984 received over $2.6 billion in tax assistance.[28] Families in the bottom quintile received almost 22% of the tax assistance, while families in the top quintile received only 10% of the tax assistance. Families claiming the DCTC in 1997 received over $2.4 billion in tax assistance through the credit, and a smaller proportion of this assistance went to low-income families than in 1984.[29] Only 10% of the tax assistance went to families in the bottom quintile, while 22% of the tax assistance went to families in the top quintile. In total, 1 million fewer families in the bottom quintile filed for the DCTC in 1997 than in 1984, and the families in the bottom quintile claiming the DCTC in 1997 received $325 million less than similarly situated families did in 1984.[30]

- **Inflation has dramatically diminished the value of the DCTC for all families.** The DCTC's qualifying expense limits have not been increased since 1981, and are not indexed for inflation. As a result, while the cost of child and dependent care has increased, the amount of qualifying expenses that determines the maximum DCTC has remained the same, diminishing for all families the credit's value in offsetting actual care expenses. Merely to restore the value of the expense limits as enacted in 1981 would require changing the limits from $2,400 for the care of a single dependent to $4,500 in 2000 dollars, and from $4,800 for the care of two or more dependents to $9,000 in 2000 dollars.[31]

IV. How to Strengthen the Dependent Care Tax Credit for Families with Employment-Related Child Care Expenses

Several changes should be implemented to strengthen and restore the value of the DCTC, especially for low- and moderate income families with employment-related child care expenses:

- **The DCTC should be refundable.** Low- and moderate-income families who have no or low federal income tax liability receive no or very little benefit from the credit because it is non-refundable. Without refundability, the DCTC is unavailable to the very families it is designed to help the most. The DCTC should be made refundable to restore the targeted value of the DCTC to those families who need the greatest assistance with child care expenses.

- **The DCTC should be indexed for inflation.** The DCTC's lack of indexing has eroded the value of the credit for families at all income levels and, in combination with its non-refundability, the credit's lack of indexing has reduced significantly the number of low- and moderate-income families who can benefit from the credit. Both the expense and income limits should be adjusted annually for inflation, as are all other basic tax provisions that determine individual tax liability. Indexing the DCTC would prevent the DCTC from continuing to suffer an erosion in value, and would prevent low- and moderate-income families from continuing to receive little or no tax assistance in meeting their child care expenses.

- **The limits on qualifying child and dependent care expenses should be raised.** The DCTC would provide more meaningful assistance to families with child and adult care expenses if the limits on qualifying expenses more accurately reflected the cost of care today. As shown above, inflation alone has greatly diminished the value of the dependent care expenses that qualify for a credit. The expense limits should be raised to an amount that fairly reflects the cost of purchasing care today, rather than the cost of purchasing care almost two decades ago.

- **<u>The percentages of qualifying expenses that may be taken as a credit should be raised.</u>** Currently, families receive a credit for only a small percentage of their actual child or dependent care expenses (20% to 30% of their qualifying expenses). Raising the percentages would help families cover the cost of more of these expenses. Moreover, raising the percentages would especially help low-income families, who are less likely than other families to spend up to the maximum care expense limits and are losing a greater proportion of their income to care expenses than other families.

Finally, the DCTC should continue to provide tax assistance for families at every income level:

- **<u>The DCTC should remain available to families at all income levels.</u>** One feature of the DCTC that should not be changed is its availability to families at all income levels. Although it can be argued that higher-income families do not need help in paying for child care, to impose an income limitation on the DCTC would make it the only employment-related tax benefit with an income ceiling. The result would be that taxpayers at all income levels could deduct business-related expenses for exclusive club memberships, luxury business cars and conventions in exotic locations, but not for the child and other dependent care that enables them to work. Singling out the DCTC, while leaving these and other employment-related expenses untouched, sends the signal that the child and other dependent care needs of working families are optional and less important than other employment-related expenditures. If Congress wants to limit tax assistance for employment-related expense, it should impose an income limit on **all** such assistance, not single out the child and dependent care assistance that is essential to so many families' economic livelihood.

REFERENCES

1. Internal Revenue Service, Statistics of Income Bulletin (Winter 1999), Individual Income Tax Returns, 1997, Table 2.

2. The scope of this paper is limited to evaluating and suggesting improvements to the assistance that the DCTC has historically offered to families with employment-related child care expenses. This paper does not address recent proposals to offer assistance to stay-at-home parents by extending the DCTC to families with young children who have no employment-related child care expenses. In addition, although families with children may receive tax assistance through other tax credits, such as the Earned Income Tax Credit and the $500 Child Tax Credit, this paper does not address the assistance that these tax credits provide to families with children.

3. An expense is "employment-related" for the purposes of claiming the DCTC if it is a child or dependent care expense that is necessary to enable the taxpayer to be gainfully employed or to seek gainful employment. 26 U.S.C. § 21(b)(2); (insert volume) C.F.R. §1.44A-1(c)(1).

4. 26 U.S.C. § 21(c) and (d).

5. *Id.*

6. 26 U.S.C. §21(d).

7. *Id.*

8. 26 U.S.C. § 21(b)(2).

9. 26 C.F.R. §1.44A-1(5)(I).

10. Caspar, L., What Does It Cost to Mind Our Preschoolers?, Current Population Reports, Household Economic Studies, P70-52 (Washington, D.C.: Bureau of the Census, U.S. Department of Commerce, Sept. 1995), Table 3.

11. Adminstration for Children and Families, Dep't of Health and Human Services, Access to Child Care for Low-Income Working Families, (1999), p. 3.

12. Bureau of Census, U.S. Dep't of Commerce, Current Population Reports, P60-197, Money and Income in the United States: 1997 (1998).

13. Bureau of Census, U.S. Dep't of Commerce, Historical Income Tables-Families, Table F-10 (1998).

14. Charlene Harrington et al., 1995 State Data Book on Long Term Care: Program and Market Characteristics 33, 133 (1996). These average costs are based on Medicaid reimbursement rates and vary from state to state. Adult day care programs generally provide health, social, personal care, and related support services for functionally or mentally impaired adults.

15. These calculations are based on the federal income tax standard deduction for a married couple filing jointly and the personal exemptions for a four-person family for tax year 2000. The calculations do not include the DCTC, the EITC or the $500 per-child tax credit.

16. These calculations are based on the federal income tax standard deduction for a head of household and the personal exemptions for a two-person family for tax year 2000. The calculations do not include the DCTC, the EITC or the $500 per-child tax credit. Annual minimum wage earnings are based on 40 hours a week, 52 weeks a year, at $5.15 an hour, the current minimum wage.

17. These annual minimum wage earnings are based on 40 hours a week, 52 weeks a year, at $5.15 an hour, the current minimum wage.

18. The Economic Recovery Act of 1981 annually indexed the personal exemption, standard deductions and tax brackets, with the indexing to begin in tax year 1985. The Tax Reform Act of 1986 annually indexed the EITC, with the indexing to begin in tax year 1987. The Tax Reform Act of 1986 also substantially increased the standard deductions and personal exemptions. This one-time increase in the amounts of the standard deductions and personal exemptions, which was in addition to the annual indexing of these tax code provisions, has contributed in part to the erosion of the DCTC's value by widening the gap between the income levels at which a family may claim the maximum DCTC percentages and the income levels at which families incur federal income tax liability.

19. In 1984, a married couple with two children filing jointly would owe federal income taxes if they had an income greater than $7,400, and a single parent with one child would owe federal income taxes if he or she had an income greater than $4,300. These calculations are based on the federal income tax standard deductions and personal exemptions for tax year 1984.

20. Internal Revenue Service, Statistics of Income, Individual Income Tax Returns,1984, Table 3.3 (1986). 1984 is used as a benchmark for showing the decline in the number of low-income families claiming the DCTC due to the DCTC'S lack of indexing and refundability because 1984 is the last tax year in which none of the tax code's basic provisions were indexed.

21. *Id*; Bureau of Census, U.S. Dep't of Commerce, Historical Income Tables, Table F-1, Income Limits for Each Fifth and Top 5 Percent of Families (All Races): 1947 to 1997. These quintiles represent the income quintiles of the entire U.S. population and are not limited to the portion of the population that files federal income tax returns. The upper income limit of the bottom quintile in 1984 was $12,575. Due to limitations in published income tax data, the estimate of the proportion of families in the bottom quintile claiming the DCTC in 1984 includes families with an adjusted gross income of up to $15,000.

22. The upper income limit of the third quintile in 1984 was $31,684. Due to limitations in published income tax data, the estimate of the proportion of families in the first three income quintiles claiming the DCTC in 1984 includes families with an adjusted gross income of up to $30,000.

23. The lower income limit of the top quintile in 1984 was $45,564. Due to limitations in published income tax data, the estimate of the proportion of families in the top quintile claiming the DCTC in 1984 includes families with an adjusted gross income greater than $50,000.

24. Part of the overall decline in the number of families who claimed the DCTC between 1984 and 1997 is due to changes in the DCTC contained in the Family Support Act of 1988. The Family Support Act required that, beginning in 1989, all taxpayers claiming the DCTC provide the care provider's name, address and taxpayer identification number on their tax returns; a qualifying child be under age 13 (lowered from 15); and taxpayers receiving tax-free assistance from their employers under a dependent care assistance program reduce by the amount that assistance the amount they claim under the dependent care credit. These changes combined resulted in 31% fewer families at all income levels claiming the DCTC for tax year 1989 than for tax year 1988. Although the changes in the Family Support Act contributed to some of the decline in the number of low- and moderate-income

families who claim the DCTC, the number of these families has continued to drop since 1989 when the Family Support Act changes were implemented -- in 1997, 11% fewer families in the bottom three income quintiles claimed the DCTC than in 1989. Internal Revenue Service, Statistics of Income, Individual Income Tax Returns, 1989, Table 3.3, and Individual Income Tax Returns, 1997, Table 2.

25. Internal Revenue Service, Statistics of Income, Individual Income Tax Returns, 1997, Table 2.

26. The upper income limit of the third quintile in 1997 was $53,616. Due to limitations in published income tax data, the estimate of the proportion of families in the bottom quintile claiming the DCTC in 1997 includes families with an adjusted gross income of up to $50,000.

27. The upper income limit of the bottom quintile in 1997 was $20,586. Due to limitations in published income tax data, the estimate of the proportion of families in the bottom quintile claiming the DCTC in 1997 includes families with an adjusted gross income of up to $20,000.

28. Individual Income Tax Returns, 1984, Table 3.3.

29. Individual Income Tax Returns, 1997, Table 2.

30. These differences are based on data provided in Individual Income Tax Returns, 1984, Table 3.3, and Individual Income Tax Returns, 1997, Table 2.

31. These calculations are based on the following formula: Amount in 2000 dollars = (Amount in 1981 dollars/Average CPI-U for 1981) x (Estimated CPI-U for 2000, based on the Congressional Budget Office inflation forecast for 2000).

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How the Clinton Administration's Proposal Would Expand the Child and Dependent Care Tax Credit

The Clinton Administration has proposed to expand the Dependent Care Tax Credit as part of a multi-faceted plan to assist families with their child care needs. Overall, the Administration estimates that the proposal would increase tax relief for over 8 million families by $30 billion over the next ten years.[1]

Table 1: Comparison of the Value of the Current Dependent Care Tax Credit with the Value of the President's Proposed Expansion of the Dependent Care Tax Credit at Selected Income Levels

ADJUSTED GROSS INCOME	PERCENT OF CARE EXPENSES CREDITED		MAXIMUM CREDIT FOR FAMILIES WITH CARE EXPENSES AND 1 CHILD*/DEPENDENT		MAXIMUM CREDIT FOR FAMILIES WITH CARE EXPENSES AND 2 OR MORE CHILDREN*/ DEPENDENTS		MAXIMUM CREDIT FOR FAMILIES WITHOUT CARE EXPENSES AND 1 / 2 OR MORE CHILDREN UNDER AGE 1
	Current Law	Clinton Proposal	Current Law	Clinton Proposal	Current Law	Clinton Proposal	Clinton Proposal Only
≤ $10,000	30%	50%	$720	$1,200	$ 1,440	$2,400	$250 / $500
$20,000	25%	50%	$600	$1,200	$ 1,200	$2,400	$250 / $500
$30,000	20%	50%	$480	$1,200	$ 960	$2,400	$250 / $500
$40,000	20%	40%	$480	$ 960	$ 960	$1,920	$200 / $400
$50,000	20%	30%	$480	$ 720	$ 960	$1,440	$150 / $300
> $59,000	20%	20%	$480	$ 480	$ 960	$ 960	$100 / $200

* The figures in these columns refer to families with no children under age one.

How the Dependent Care Tax Credit Currently Works

The Dependent Care Tax Credit (DCTC) allows families to reduce their federal income tax liability by a percentage of their expenses for the care of a child, spouse, or dependent who is unable to care for herself or himself, when such care is needed to allow the taxpayer, and the taxpayer's spouse, if married, to work or seek employment. Under current law, the credit ranges from 30 to 20 percent of a family's qualifying child and dependent care expenses, up to $2,400 for each child or dependent, not to exceed $4,800. The percentage that may be claimed as a credit is reduced as a family's adjusted gross income (AGI) increases, thus offering a greater benefit to lower income families. **Currently, the maximum credit ranges from $1,440 for families with AGIs of $10,000 or less and two or more children or dependents ($720 for one child or dependent), to $960 for families with AGIs of $28,000 or more and two or more children or dependents ($480 for one child or dependent).** The credit is not refundable. Therefore, if a family's credit exceeds its tax liability, it cannot take advantage of the full value of the credit.

The Clinton Administration's Proposed Changes in the Credit

The Administration's proposal makes four main changes to the DCTC:

1. **Increases the amount of the credit for most eligible taxpayers.**
Beginning in 2003, families with qualifying child or dependent care expenses and income of $59,000 or less and families at any income level with a child under age one would receive a larger credit under the Administration's proposal than under current law. Whereas the maximum value of the DCTC is currently $720 for a family with one child or dependent and $1,440 for a family with two or more children or dependents, under the Administration's proposal families could receive as much as $1,200 if they have one child age one or over or a dependent, and as much as $2,400 if they have two or more children age one or over or two or more dependents. Table 1 compares the maximum credit available to families at selected income levels under current law and under the Administration's proposal. Figures 1 and 2 present this information graphically. The phase-in of this increase would begin in 2003 and would be complete by 2005.

2. **Increases the credit for families with children under age one, whether or not they have employment-related child care expenses.**
Beginning in 2001, a nonrefundable credit would be available for families with children under age one, even if they have no out-of-pocket, employment-related child care expenses. Families without such expenses would be deemed to have $500 in qualifying child care expenses for one infant or $1,000 for two or more infants. Families with such expenses would be allowed to add $500 for one infant or $1,000 for two or more infants to their amount of qualifying child care expenses. The effect of this change would be to give families with one infant as much as $250 more than they otherwise would receive through the credit and families with two or more infants as much as $500 more. Table 2 gives some examples of the maximum credit that families could receive under this proposal.

Table 2: Maximum Value of the DCTC for Families with Children Under the Clinton Administration's Proposal

	AGI ≤ $30,000 and maximum in employment-related child care expenses	AGI > $59,000 and maximum in employment-related child care expenses	AGI ≤ $30,000 and no employment-related child care expenses	AGI > $59,000 and no employment-related child care expenses
No children under age one:				
Family with one child	$1,200	$480	$0	$0
Family with two+ children	$2,400	$960	$0	$0
One child under age one:				
Family with one child	$1,450	$580	$250	$100
Family with two+ children	$2,650	$1,060	$250	$100
Two+ children under age one:				
Family with two+ children	$2,900	$1,160	$500	$200

3. **Makes the credit refundable.**
Beginning in 2003, the DCTC would be refundable. Many low-income families cannot take advantage of the current DCTC because they have no tax liability. By making the credit refundable, the proposal ensures that if the amount of a family's credit exceeds its tax liability, the family will receive that amount in the form of a tax refund. This feature of the proposal would increase by as much as $2,400 the tax refund received by very low-income families with two or more children or dependents. (The refund of a family with only one child or dependent would increase by as much as $1,200).[2]

4. **Indexes expense limits and AGI levels for inflation.**
Beginning in 2002, the limits on qualifying expenses and the AGI levels for determining the applicable credit rate would be adjusted for inflation.[3] This indexing would allow the DCTC to keep pace with inflation, as most of the other basic tax code provisions already do, including the personal exemption, standard deduction, tax brackets, and, for low-income taxpayers, the Earned Income Tax Credit.

The Impact of the Proposed Changes on Families

Families with children and AGIs below 133 percent of the poverty line currently receive no net tax benefit from the DCTC because of its interaction with the child tax credit.[4] The Administration's proposal would for the first time enable these families to take full advantage of the DCTC. The amount received by families at these income levels could increase from zero under current law to as much as $2,400 under the Administration's proposal for families with two or more children age one or over or two or more dependents ($1,200 for families with one child age one or over or one dependent).

Many low-income families cannot afford (and therefore claim a credit based on) the maximum qualifying expenses. For these families with employment-related child care expenses, the subsidies provided through the Child Care and Development Block Grant (CCDBG) are critical. However, only 10 percent of the families eligible for child care subsidies under federal eligibility rules actually receive CCDBG assistance.[5] The families who qualify for but do not receive these subsidies could receive some assistance with child and dependent care expenses through the DCTC if the Administration's proposal were adopted. Even for families who currently receive subsidies, the proposal could help them to offset the often sizable co-payments they must make for subsidized care. Moreover, because this assistance is available through the tax system, it is available to all eligible families who file a tax return and is not dependent on the annual appropriations process that limits the reach of CCDBG subsidies.

Low- and middle income families who already receive some tax assistance through the current DCTC would experience lower but still substantial increases in the size of the maximum credit they could receive as a result of the Administration's proposal. For example, families with incomes between $20,000 and $40,000 would see the amount of their maximum credit at least double. This doubling translates into an increase of between $480 and $720 for families in this income range with one child age one or over or a dependent and between $960 and $1,440 for families with two or more children age one or over or two or more dependents. Families with under current law if they have one child age one or over or a dependent. Families in this income range with two or more children age one or over or two or more dependents would receive between $48 and $912 more.

Finally, families with incomes above $59,000 would only receive an increase under this proposal if they have a child under age one. At this income level, families would receive $100 if they have one infant and $200 if they had two or more infants, in addition to any credit amount they would receive under the other provisions of the DCTC. This nonrefundable credit for infants would also be available to families at lower income levels. Depending on their income level, families could receive as much as $500 more than they could otherwise receive through the DCTC if they have two or more infants, and as much as $250 more if they have one infant.

Many families, especially those with low incomes, cannot afford to pay up front for child or dependent care expenses and await reimbursement the following year when they file their tax returns. Proposals to improve the DCTC should include a mechanism to allow families to receive their credit periodically throughout the year instead of as a lump-sum when they file their tax returns. Such a system could be modeled after the advanced payment option available to recipients of the Earned Income Tax Credit. The combination of making the DCTC refundable and distributing it periodically throughout the year could help families pay for higher quality care than they could otherwise afford, particularly low-income families.

ENDNOTES

1. This description of the President's proposed expansion of the Dependent Care Tax Credit is based on summaries provided by the Administration, and is subject to elaboration as the proposal is more fully developed. The calculations in this paper were made as if the changes were fully effective in tax year 2001; their actual effective dates are mentioned in the text.

2. These amounts could theoretically be higher if the tax credit for infants were included. But since the credit for families with infants is not refundable, very low-income families would not be able to take advantage of it.

3. The $30,000 starting point for the gradual decrease of the credit rate from 50 percent to 20 percent would be indexed for inflation. The credit rate would continue to be reduced by one percentage point for every $1,000 above the starting point, eventually reaching 20 percent and holding steady at that level.

4. The following are the thresholds below which families receive no net tax benefit from the DCTC once the interaction with the child tax credit is considered: single parent with one child, $15,783; single parent with two children, $22,017; married couple with one child, $19,583; married couple with two children, $25,817.

5. U.S. Department of Health and Human Services, Administration for Children and Families, *Access to Child Care for Low-Income Working Families*, October 1999.

Figure 1
Value of DCTC Under Current Law and Under the Clinton Administration's Proposal for Families with One Child or Dependent and the Maximum in Qualifying Expenses at Selected Income Levels

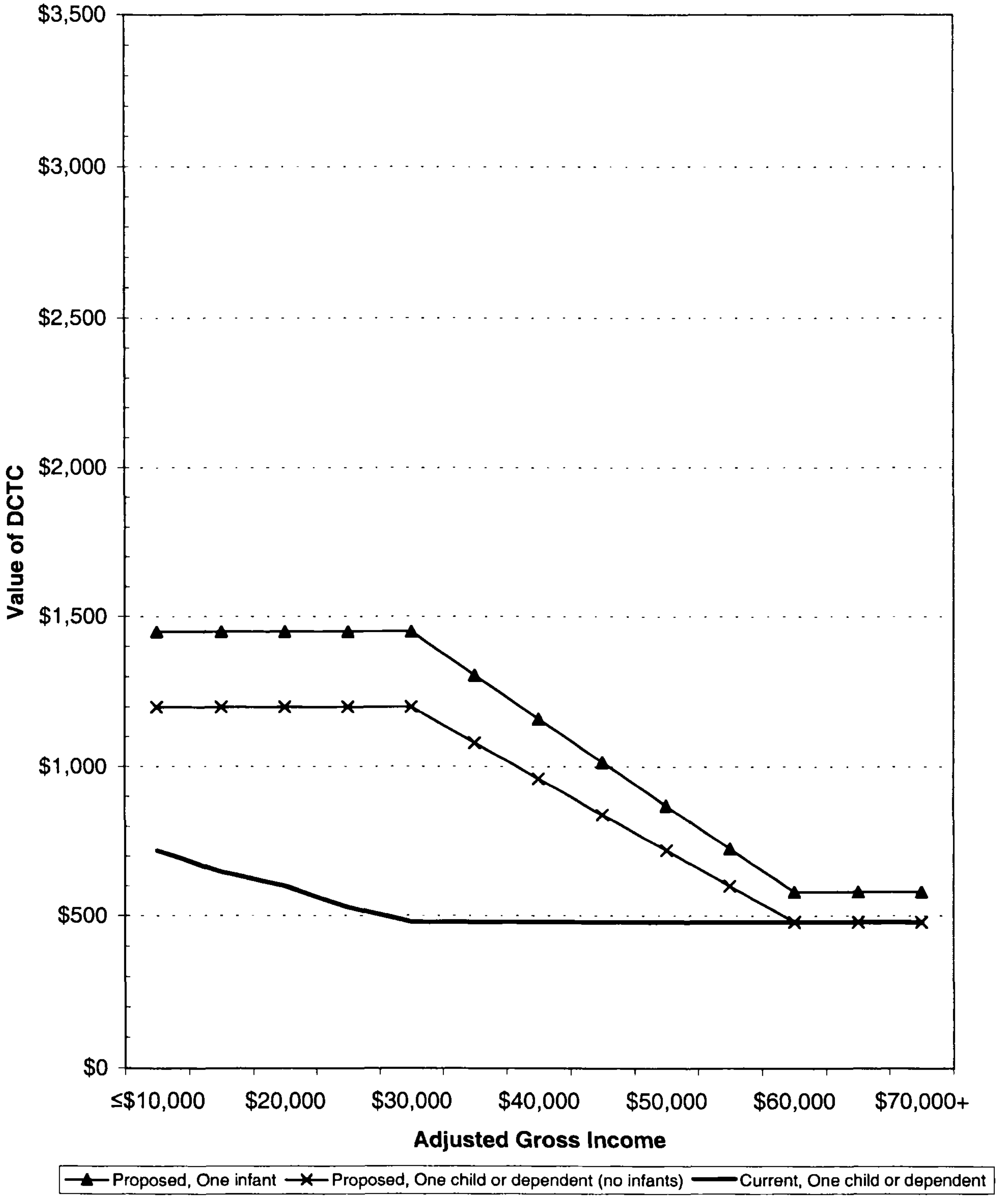
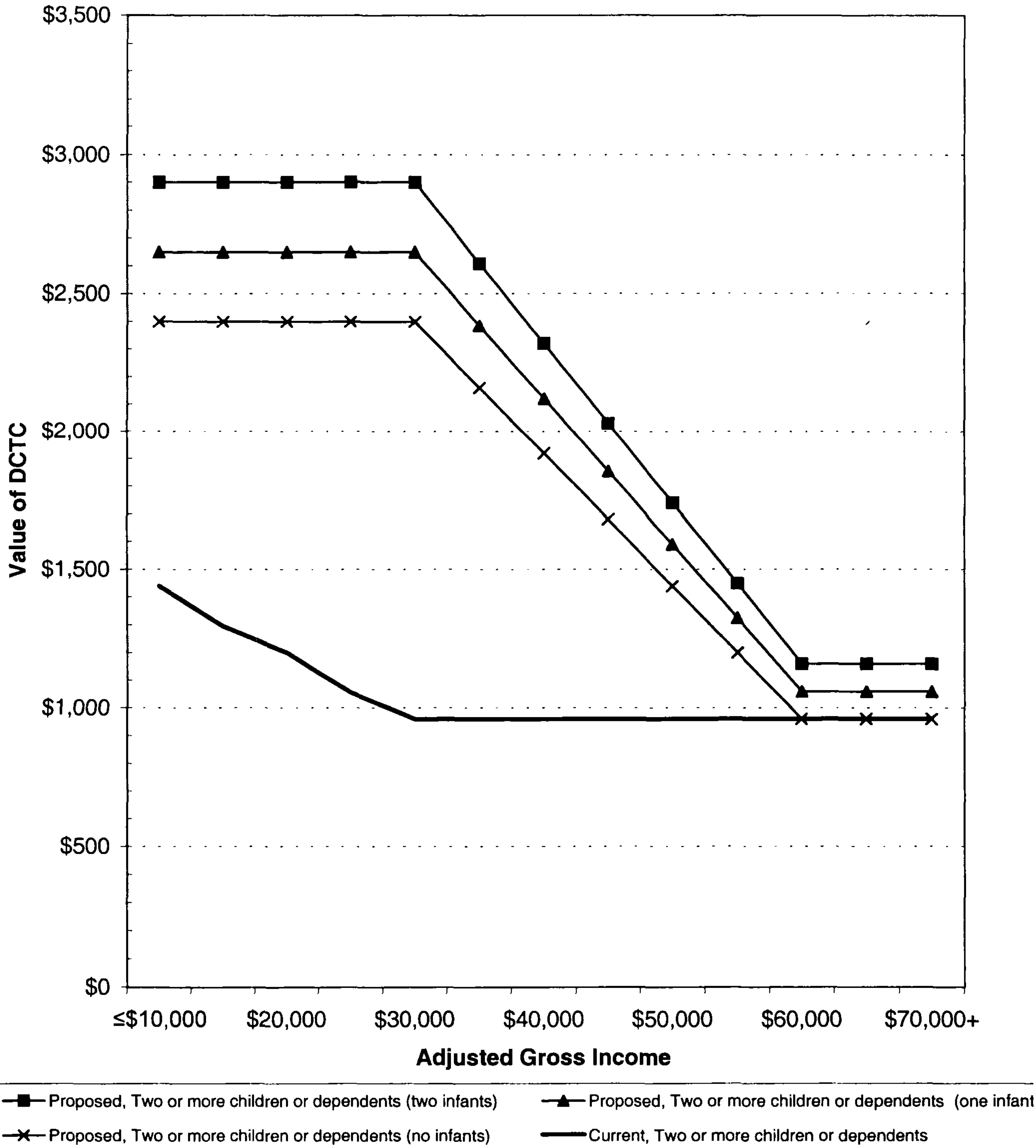


Figure 2
Value of DCTC Under Current Law and Under the Clinton Administration's Proposal for Families with Two or More Children or Dependents and the Maximum in Qualifying Expenses at Selected Income Levels



Ann O'Leary
02/10/2000 02:15:15 PM

Record Type: Record

To: Ruby Shamir/OPD/EOP@EOP
cc:
bcc: Records Management@EOP
Subject: Re: DCTC breakdown -- 5 yrs

1.2 bill

15 million

Thank you. Sorry about all of the confusion.

Ruby Shamir

2.3 billion

Ruby Shamir
02/10/2000 02:12:56 PM

Record Type: Record

Children tax exemption
11.2 bill

To: Ann O'Leary/OPD/EOP@EOP
cc:
bcc:
Subject: Re: DCTC breakdown -- 5 yrs

Sorry this is late, but here is the other information I have on the tax cut, which you probably already got:

Tax Credit Expansion:	$2.4 billion over 5 years;
Stay At Home:	$972 million over 5 years
Refundability:	$4.095 billion over 5 years
TOTAL:	$7.46 billion over 5 years

Ann O'Leary

Ann O'Leary
02/10/2000 12:42:05 PM

Record Type: Record

To: Paul J. Weinstein Jr./OPD/EOP@EOP, Ruby Shamir/OPD/EOP@EOP, Jason Furman/OPD/EOP@EOP
cc:
Subject: DCTC breakdown

Treasury is using the following breakdown for DCTC over 10 years:

DCTC Expansion of Tax Credit (w/o stay at home piece) -- $8.5 billion over 10
Stay at home piece -- $2.3 billion
Refundability -- $19.5 billion

CHILD SUPPORT ENFORCEMENT - Mandatory Funding
(OL in millions of dollars)

FY 1999	FY 2000 Req.	House	Senate	Alternative Level
Base program				
3,080	3,280	NA	NA	

Savings Proposals (non-add)	FY 2000*
Reduce paternity match	-9
Repeal hold harmless provision	-65
Mandatory review of child support orders	0

* FY 2000 - 2004 savings: Reduce paternity match -$45 million, Repeal hold harmless -$279 million, Mandatory review of child support orders -$85 million.

Subcommittee: Labor/HHS/ Education

2000 Budget Policy: The Budget includes three child support proposals that would save a total of $409 million in mandatory funding over five years, none of which would have a negative programmatic impact. The budget would:

- reduce the 90 percent Federal paternity match to 66 percent (5 year savings: $45 million);
- repeal the "hold harmless" provision, which guarantees States their 1995 level of collections (5 year savings: $279 million). (This proposal is included in the House-passed H.R. 1802, the Foster Care Independence Act. The bill has not been introduced in the Senate);
- require States to review child support orders for TANF families every three years, beginning in FY 2001 (5 year savings: $85 million).

Latest House Action: Draft materials informally released by the House Appropriations Subcommittee propose reducing the Federal child support match from 66 percent to 50 percent. CBO estimates that this proposal saves $850 million in FY 2000 and $5.2 billion through FY 2004. OMB estimates are under development.

Latest Senate Action: None.

Alternative Level/Programmatic Implications: Oppose the potential House Appropriations proposal to reduce the Federal match on child support enforcement to 50 percent. At such short notice, it would be very difficult for States to offset the reduction in Federal spending, if the provision were enacted for FY 2000. Many States would reduce their child support enforcement efforts, resulting in lower collections for children and families, and undermining the Administration's goal of moving low-income families from welfare to work.

Alternatively, a small reduction from the current match rate proposed by Congress could be accepted, without adverse programmatic impact. A two percentage point reduction to 64 percent saves $81 million in FY 2000 and $486 million from FY 2000-FY 2004. However, the Administration has committed to developing a budget neutral child support financing proposal; child support constituencies would likely oppose any reductions beyond those it has already proposed. The Administration may wish to reserve this offset to pay for a proposal in the FY 2001 budget that would direct more child support collections to families.

FY 1999 Appropriations Action: None.

Prepared By/Date: Michele Ahern, 8/30/99, (j:\data\99-51\la\F_cse.wpd)

COMPREHENSIVE SCHOOL REFORM DEMONSTRATION
(BA in millions of dollars)

	FY 1999	FY 2000 Req.	House	Senate	Alternative Level
*Title I schools**	120	150	NA	NA	
*All other schools**	25	25	NA	NA	
Total:	145	175	NA	NA	

** Funding for the program is in two accounts: in Title I for high poverty schools and in the Fund for the Improvement of Education in the Education Research, Statistics, and Improvement account for all other schools.*

Subcommittee: Labor/HHS/ED

2000 Budget Policy: The FY 2000 Budget requested $150 million under Title I, an increase of $30 million over last year for the Demonstrations in Comprehensive School Reform Program, for Title I schools. Because this program places a priority on reducing drop-out rates, a key issue in the Hispanic community, it is part of the Hispanic Initiative. The increase would enable States to fund, at the minmum level of $50,000 each, almost 600 new comprehensive school reform projects in Title I schools, in addition to continuing almost 2,400 supported with 1999 funds. The $25 million in comprehensive reform grants for which Title I and non-Title I schools are eligible is requested under the Fund for the Improvement of Education (FIE), and would continue approximately 500 reform projects. The distinguishing characteristic of the program is that grant recipients must implement whole-school models that research shows are effective.

Latest House Action: The unofficial draft Republican mark provided $120 million in Title I for this program, $30 million below the request and the same as last year. This would support grants to 600 fewer schools than in the President's budget. FIE is provided $76 million, a cut of $63 million (45%) below the FY 1999 level, and therefore may not maintain the $25 million for CSRD; if zeroed out, an additional 500 schools would no longer receive grants.

Latest Senate Action:

Alternative Level:

FY 1999 Appropriations Action: The CSRD was created through the 1998 Appropriations Act by Representatives Obey and Porter. In FY 1999, the Administration requested $150 million to support comprehensive school reform in Title I schools and $25 million for all schools through FIE. Congress provided $120 million for Title I schools and the request for FIE.

Prepared By/Date: Mary Cassell, 5-5881, 8/17/99, f_CSRD.wpd