

The Child Care Tax Credit: Too Little, Too Late

Child care is an expense that many working parents must face in order to find and keep their jobs. As a genuine, legitimate working expense, the cost of child care should be tax deductible. The federal Dependent and Child Care Tax Credit exists for this reason. However, it has become increasingly inadequate for meeting the needs of working families.

The origin of the credit was a 1954 provision establishing a deduction for employment-related care expenses. The deduction became a credit in 1976. It was raised in 1981 to \$2,400 for one child and \$4,800 for two or more. It was not raised again until tax year 2002 when families will be able to claim up to \$3000 in expenses for one child and \$6000 for two. Unfortunately, the new limits are still too low, and the program has several fundamental flaws.

Facts About the Dependent and Child Care Tax Credit:

- **The claim limits are not indexed for inflation**
 - Until 2002, there had not been a change in the limits since they were established in 1981. The increase for tax year 2002 to \$3000 (one child) and \$6000 (two children) still leaves the tax credits at only two-thirds the level they should be. In 1981, the limits reflected the cost of care, but they have not risen with the consumer price index. If the credit had been indexed for inflation, it would now be worth **\$4,596** for one child and **\$9,192** for two, much closer to the current cost of care.
 - It is important to note that other elements of the tax code, the personal exemption, the standard deduction, and the earned income credit, are all indexed for inflation. Additionally, the home mortgage deduction has no limit for homes under \$1 million.
- **The credit doesn't work for married parents**
 - Married couples must file for the credit jointly. This cuts their eligibility almost in half, because the credit is based on a sliding scale of income. Family income determines the percentage (from 20% to 35%) of child care expenses that can be claimed for credit. The scale only allows \$2000 more for married parents' joint income than for a single parent's income. The lowest income limit for *married* taxpayers, at which families can claim 35%, will be only \$17,000 in 2002. Many families who make more than this are still very low income.
- **Income limits are not indexed for inflation**
 - The highest income level at which a *single* head of household can claim the maximum 35% of expenses is \$15,000 in 2002 (up from \$10,000). This is so low that it excludes many working single parents from the highest level of assistance. If this income cutoff had been indexed for inflation it would now be **\$18,352**.
- **The credit is not refundable**
 - The non-refundability of the tax credit keeps the lowest-income families from benefiting, as those families whose tax liability is zero receive no help.
 - Refundability is a feasible option: New York State recently made its dependent care credit refundable, helping many poor working families who were receiving

no help from the federal credit. Unfortunately, New York is one of only ten states with a refundable credit.¹

- **Issues for changing policy**

- The policy dialogue must value child care as a social responsibility. For policy-makers to back appropriate federal support for childcare, the issue has to be presented as one that has a profound effect on the whole community.
- In 2000, the federal government expended \$97 billion in forgone tax revenue for the Home Mortgage Interest Deduction.² This amount was 0.62% of the gross domestic product (GDP) in 1999, while the cost of the child care tax credit was only 0.03% of the GDP.³ Why does our government value home ownership more than children?
- There are 25,885,000 families in the United States with children under 12, but only 5 million American families make claims each year on the child care tax credit.⁴ Parents deem the amount of money available not worth the investment of time, or are not being educated about the existence of the credit.

¹ All calculations presented thus far are found in “Making Care Less Taxing” by the National Women’s Law Center. Available online at <http://www.nwlc.org>

² Cherry, Robert and Sawicky, Max. “Giving Tax Credit Where Credit is Due.” April 2000. Available online at <http://www.epinet.org/briefingpapers/eitc.html>

³ Toder, Eric J. “The Changing Composition of Tax Incentives, 1980-99.” The Urban Institute: March 1999. Available online at http://www.urban.org/tax/austin/austin_toder.html

⁴ U.S. Census Bureau. <http://www.census.gov>