Could Better Tax Policy Help Families Pay for Child Care?

Child & Dependent Care Credit[vi]

Parents who are working or in school can qualify for the Child and Dependent Care Credit. It provides a credit of between 20 and 35 percent of child care costs at a maximum of $3,000 for one child under age 13 or $6,000 for two or more children. Currently, the Child and Dependent Care Tax Credit is not refundable. Therefore, if families are low-income and don't owe income taxes, they cannot benefit from the credit.

Dependent Care FSA[vii]

A Dependent Care Flexible Spending Account (DCFSA) is a pre-tax benefit account used to pay for services like pre-school, summer day camp, before- or after-school programs, and child or adult daycare. The amount that a parent specifies is withdrawn from his or her paycheck for deposit into a flexible spending account before taxes are deducted, so parents do not pay taxes on that amount.

A national conversation is currently playing out about how to use tax policy to help families pay for child care. High quality child care and early education provides children with a foundation for academic success and supports parents' ability to work and sustain their families. It also helps build a strong workforce ready for 21st century jobs.

Paying for child care is one of the biggest challenges faced by working families. In fact, a recent report by Child Care Aware of America found that the cost of one year of infant child care in most states, including North Carolina, is considerably more than the cost of one year of college tuition at a four-year public university ($9,300 vs. $7,000 in NC).

In North Carolina, the cost of care averages 12 percent of income for a two-parent family with an infant in care, 41 percent of income for a single parent with an infant in care, and a whopping 75 percent of income for a single parent with two children in care. According to the U.S. Department of Health and Human Services standard, any child care that costs more than seven percent of a family's income is considered unaffordable.

Last year, North Carolina's U.S. Senator Richard Burr teamed up with U.S. Senator Angus King (I-Maine) to introduce the *Promoting Affordable Child Care for Everyone* (PACE) Act. The legislation would make important updates to the federal Child and Dependent Care Tax Credit and the Dependent Care Flexible Spending Account programs that would especially benefit low- and moderate-income families, including:

Making the Child and Dependent Care Tax Credit refundable, which would expand its reach to low-income working parents. A refundable tax credit can reduce a family's tax liability below zero and qualify them for a tax refund. If the amount of the credit is larger than the tax they owe, they would receive the difference.

Increasing the value of the credit by raising the rate for all families. Currently, a family can receive a 20-35 percent reimbursement of childcare expenses. Under the new proposal, families would be reimbursed for between 35 and 50 percent of expenses.

Setting a higher rate for low-income families than for higher-income families, which expands the reach of the credit for those who are struggling more to meet these costs. Low-income families would receive the higher 50 percent reimbursement rate.

Allowing families to put more pre-tax dollars into Dependent Care Flexible Spending Accounts.

Adjusting for inflation both the amount of the tax credit and the amount that can be invested in Flexible Spending Accounts, so that those benefits increase as costs go up and families can maintain their buying power.

The President's Proposal

President Trump has also released a tax proposal that includes reforms aimed at helping families pay for childcare. While the PACE Act is aimed at helping low- and moderate-income families afford childcare, the President's plan would disproportionately benefit higher-income families. Analysis of the plan by the non-partisan Tax Policy Center finds that about 70 percent of its benefits go to families with at least $100,000 in income (about 36 percent of families), and 25 percent of benefits go to families with at least $200,000 in income (about 13 percent of families). Very few benefits go to the lowest-income families who are likely to struggle most with paying for child care.[viii]

There are three main features of the President's proposal[ix]

1. A **tax deduction** up to the average cost of care in the state (for example, $9,300 for infant care in NC, as noted above)
2. A **Dependent Care Savings Account** (DCSA) to pay for current or future child or dependent care expenses, with a government match for lower-income families
3. A **Child Care Tax Rebate**, structured as a refundable credit on child care expenses through the EITC

The tax deduction would benefit wealthy families more than poor families.	
The tax deduction is available for families making up to $500,000 per year ($250,000 for single individuals), including families with a stay-at-home parent and therefore no childcare expenses.	Because it is structured as a tax deduction (rather than a tax credit), the benefit would save higher-income families more than it would save lower-income families. While the value of a tax credit is the same for everyone (it reduces your tax burden by a set amount), the value of a deduction varies based on the tax rate you pay. Since those with more income pay a higher income tax rate, wealthier families will benefit more than low-income families from a deduction.

The Dependent Care Savings Accounts would benefit wealthy families more than lower-income families, and many low-income families would be unable to take advantage of them.		
There is no income limit for eligibility for the proposed savings accounts.	Funds invested in the savings accounts can grow indefinitely tax-free, as long as they are eventually spent on child care, after-school enrichment programs, private school tuition, or higher education. While this option would provide wealthy families who can afford to take advantage of it with a very favorable tax shelter, low-income families would be more likely to need to spend the funds to cover immediate childcare expenses and would thus see less long-term benefit.	The government match offered to "lower-income" families (undefined) would be up to $500, a limited benefit, and would only be available to families who could afford to contribute to a savings account, which is especially challenging for low-income families living paycheck-to-paycheck.

The Child Care Spending Tax Rebate would not benefit most low-income families, and those it would benefit would receive a very limited amount.		
The rebate is only available for remaining childcare expenses after the other tax provisions are applied, so most families with taxable income would not be able to take advantage of the rebate.	Those families without taxable income, who could take advantage of the rebate, would receive a very limited benefit – less than $500 if the average cost of care in the state is $6,000.	Unlike the deduction, the rebate would not be available to families with a stay-at-home parent.

Overall, the Tax Policy Center analysis finds, families with children with incomes between $200,000 and $500,000 would receive an average annual benefit of $460. Families with incomes between $50,000 and $75,000 would receive about one-third of that ($150). And families with incomes between $10,000 and $30,000 would receive average annual benefits of $10. Creating tax deductions and savings accounts for wealthier families reduces the reach of the proposed program for lower-income families.

Other Options

The First Five Years Fund has released a proposal that, while similar to President Trump's plan, would provide greater benefits to low- and moderate-income families.[x] Provisions include:

Making the Child and Dependent Care Tax Credit refundable for families with children under five years old, much like Senator Burr's PACE Act. This would help bring funding up to meet actual costs for the care of young children and would expand the credit to additional low-income families who do not currently benefit because they have limited taxable income.

Enhancing the American Opportunity Tax Credit (AOTC), and allowing it to be used for quality education programs for children under the age of five. This credit is currently applicable for post-secondary education expenses, including tuition, fees, books, and supplies, and up to $1,000 is refundable for low-income taxpayers. Expanding it to early care and offering a benefit in the form of a tax credit, rather than a tax deduction like the President's plan, ensures that lower-income families will benefit.

Expanding the definition of "qualified institutions" for tax free scholarships to include high-quality programs for children under age five. Under current law, virtually all scholarships and tuition assistance programs are tax free, as long as the assistance is used for attendance at a "qualified institution," generally defined as primary, secondary, post-secondary or vocational. Expanding the definition to include early care would benefit more young families, who are often lower-income, and more low-income families – while wealthier families are disproportionately more likely to spend money on private school and higher education, lower-income families are disproportionately more likely to need childcare to enable them to work.

Increasing limits on the Dependent Care Assistance Program (DCAP) and incentivizing employers to contribute more to employee accounts. Incentivizing more employers to provide these accounts (by providing tax credits to businesses who do so) is a way to increase benefits to low-wage employees who currently do not have as much access to these accounts as higher-wage employees.

Why Now?

The case is clear that high quality early education results in better outcomes in education, health and economic well-being for everyone in North Carolina in both the short- and long-term.[i]

High quality, affordable, reliable child care is a critical factor in parents being able to work and support their families. Seventy-five percent of mothers and half of fathers in the US say they have passed up work opportunities, switched jobs or quit a job to tend to their children.[ii] The US loses an estimated $8.3 billion in annual wages of families due to a lack of childcare.[iii]

A system of affordable, reliable childcare is essential for our country's economic vitality. Today, US businesses lose $4.4 billion annually due to employee absenteeism as a result of childcare issues.[iv] In North Carolina, businesses face a growing skills gap. By 2020, 67 percent of jobs in the state will require some post-secondary education, yet the majority of North Carolina fourth graders are not proficient readers – the single greatest predictor of high school graduation and later success. High quality childcare and early education are essential to prepare the state's workforce for a competitive future.

We know what works. High-quality childcare and early education supports children's optimal health and development, prepares them for school, and helps families support their children's learning. Recent research has shown that North Carolina's investment in early child care and education programs has resulted in higher test scores, less grade retention and fewer special education placements through fifth grade.[v]

High-quality childcare and early education is an essential foundation to prepare our future workforce and close the skills gap in NC.

Innovative State Tax Credits

At a time of limited resources, some states have created tax credits to strengthen the quality of child care, to expand access to quality child care, or to promote additional investments in child care to supplement appropriated funds. Tax credits are an additional avenue to add dollars for child care while investing in families and promoting economic development, and low-income families can benefit.

Louisiana	Oregon
Louisiana's School Readiness Credit is a broad-based effort to provide incentives for parents to choose quality child care, for providers to serve children whose care is paid for with a subsidy and raise quality on state's quality rating system, for professional development for directors and teachers, and to promote employer investments in quality care and Child Care Resource and Referral agencies to assist parents in finding quality care.	**Oregon's Child Care Contribution Credit** promotes quality care by encouraging individuals and businesses to donate to a state fund used to improve the quality of child care and to promote access to quality care.[xi]

There is no lack of ideas for policies to help families access affordable, reliable child care. The good news is that there is a recognition of the critical importance of this need, especially for working parents. The challenge is to develop a tax code that helps all families, while prioritizing low-income families who struggle the most to pay for child care.

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