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State Tax Credits for Child Care

By Elaine Maag

High costs related to child care can present a substantial barrier to work for low-income parents. Federal and state governments provide assistance to alleviate that barrier through the tax system by offering credits and deductions for child-care expenses. The main source of aid from the federal income tax system is the child and dependent care tax credit (CDCTC). For families with one child and adjusted gross income below $15,000, in theory the credit offsets up to 35 percent of expenses for the first $3,000 of child-care expenses ($6,000 for families with more than one child). The credit phases out as AGI increases, until it is worth 20 percent for families with AGI greater than $43,000. Because the federal CDCTC is nonrefundable, its benefits flow mainly to middle- and high-income families (see this column, *Tax Notes*, Oct. 27, 2003, p. 539) and lower-income families receive no benefit from the credit.

Several states have enacted child-care credits based in part on the federal credit, though some make two important distinctions that better target the credit to low-income families. Some states have enacted refundable child-care credits so that regardless of a person's income tax liability, she can benefit from the state credit and some states have opted to allow the credit only for families with AGI below a certain threshold (often set somewhere between $40,000 and $60,000).

As of 2004, 27 states offered tax credits or deductions to offset child-care expenses (see table). Thirteen states offered a refundable child-care credit — or a credit that was refundable for at least low-income families; 12 states offered child-care credits that were nonrefundable, and 3 states offered a deduction of child-care expenses (Maryland offered both a nonrefundable credit and a deduction).

States employ two options to limit eligibility of their state child-care credits to target more benefits to lower-income families. Eight states do not allow families to use a child-care credit if their income exceeds a set threshold. Those income thresholds range from $100,000 in California to $21,424 in New Mexico. Also, some states phase out their state credit as income rises so that higher-income families qualify for only a very limited credit. Others allow a flat percentage of the federal CDCTC as a state credit (ranging from 20 percent to 100 percent), but do not vary the rules for receiving the credit based on income.

As with all refundable credits, it is unclear how many eligible families actually benefit. Possibly, those who do not otherwise need to file a tax return will not file a return only to claim a tax credit, because they may not know about the credit. Some evidence suggests that individuals who use a paid preparer are more likely to report receiving other refundable credits such as the earned income tax credit (Maag 2005), which may also be the case with a refundable child-care credit.

State Child-Care Tax Credits
States with fully or partially refundable child-care credits
Arkansas, California, Colorado, Hawaii, Iowa, Louisiana, Maine, Minnesota, Nebraska, New Mexico, New York, Oregon, and Vermont
States with nonrefundable child-care credits
District of Columbia, Delaware, Idaho, Kansas, Kentucky, Maryland, North Carolina, Ohio, Oklahoma, Rhode Island, South Carolina, and Virginia
States that allow a deduction of child-care expenses
Maryland, Massachusetts, and Montana
Source: National Women's Law Center. 2002 and 2005. ''Making Care Less Taxing: Improving State Child and Dependent Care Tax Provisions.'' Washington, DC.

Reference

Maag, Elaine. 2005. ''Paying the Price? Low-Income Parents and the Use of Paid Tax Preparers,'' *Assessing the New Federalism* Policy Brief B-64. Washington, DC: The Urban Institute.