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The Disappearing Child Care Credit

By Elaine Maag

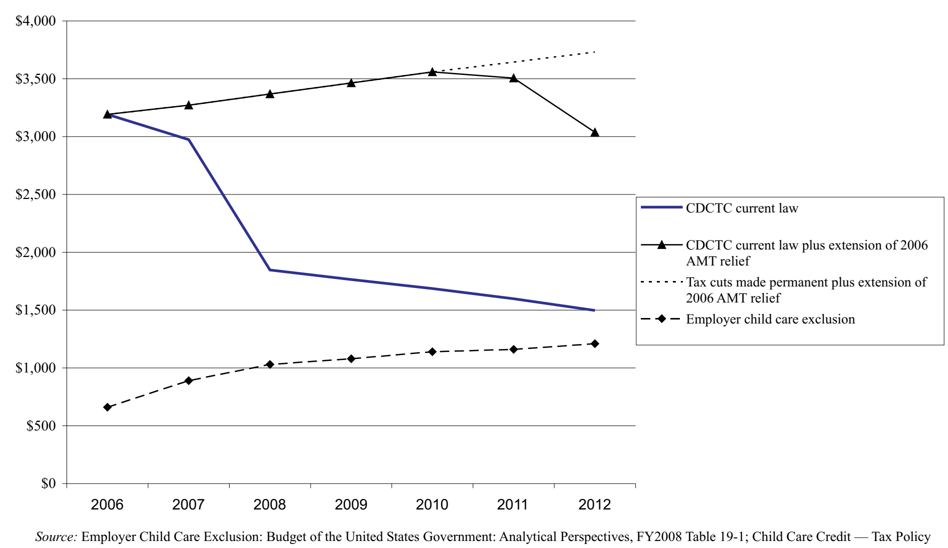
Elaine Maag is a research associate at the Urban Institute.

There are two primary tax benefits parents use to offset child care costs — the child and dependent care tax credit (CDCTC) and the employer-provided child care exclusion. To receive the former, parents may claim a tax credit of up to 35 percent on up to $3,000 of expenses per child ($6,000 total), for a maximum credit of $1,050 per child ($2,100 total). The credit rate phases down to 20 percent as adjusted gross income increases. To benefit from the employer-provided child care exclusion, employees can arrange with their employer to exclude up to $5,000 from their salary to pay for child care, regardless of the number of children receiving care.

In 2006 benefits from the two programs totaled $3.8 billion. Benefits from the CDCTC swamped those available from the exclusion, $3.2 billion to $0.6 billion, respectively (Budget of the United States Government: Analytical Perspectives, FY2008). But this piece of social policy in the tax code is slated to disappear because of its interaction with the alternative minimum tax. Benefits from the child care credit are projected to decline dramatically under current law, largely because of the increase in the number of taxpayers subject to the AMT beginning in 2008. Benefits from the child care credit decline to a much lesser extent on the expiration of the 2001 tax cuts in 2011. At that time, absent further legislative action, rules effective since before the enactment of the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA) will apply. The maximum credit rate will decrease to 30 percent, and maximum eligible expenses will decline to $2,400 per child ($4,800 total).

Under current law, the largest drop in predicted benefits from the CDCTC happens in fiscal 2008 (solid downward sloping line). This is a result of the CDCTC no longer being available to families subject to the AMT. Previously, a patch was put in place that allowed the CDCTC to be claimed against both regular tax liability and AMT liability, but that patch has not yet been extended. This provision also raised the exemption amount under the AMT, reducing the number of families subject to the AMT. The upward sloping lines show predicted benefits from the CDCTC if AMT relief is extended. There, the only drop-off in benefits happens after 2010, as a result of the EGTRRA expansions expiring. The upward sloping dotted line shows predicted benefits if the EGTRRA expansions do not expire.

Estimated Tax Expenditures for Child Care Expenses



Source: Employer Child Care Exclusion: Budget of the United States Government: Analytical Perspectives, FY2008 Table 19-1; Child Care Credit — Tax Policy Center microsimulation model, Table T07-0298.