



NEW TAX LAW INCREASES ASSISTANCE TO FAMILIES WITH CHILD AND ADULT DEPENDENT CARE EXPENSES

The tax bill signed into law by President Bush on June 7, 2001, the Economic Growth and Tax Relief Reconciliation Act, includes a provision to expand the dependent care tax credit (DCTC), effective in tax year 2003. The DCTC assists families in meeting the costs of child and adult dependent care by allowing taxpayers to offset a portion of their employment-related child and 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. However, since the credit was last expanded twenty years ago in 1981, its value has eroded significantly. The expansion of the DCTC included in the new law increases the amount of tax assistance that families will be eligible to receive to offset their child and dependent care expenses and restores some of the value of the DCTC that has been lost in the last twenty years.

How the Dependent Care Tax Credit Currently Works

The 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 per year, 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 more than \$28,000 and two or more children or dependents (\$480 for one child or dependent).** The credit is not refundable. Therefore, if a family's credit is more than its tax liability, it cannot take advantage of the full value of the credit.

How the New Law Expands the Dependent Care Tax Credit

The new law expands the DCTC as follows:

- 1. Increases the amount of the DCTC for most eligible taxpayers.**

Many families with qualifying child or dependent care expenses will receive a larger credit under the new law than under current law. The credit will increase by up to \$804 for families with two or more children or dependents (\$402 for families with one child or dependent).

- 2. Increases the DCTC's expense limits.** The new law increases the limits on qualifying expenses for determining the credit from the current \$2,400 to \$3,000 for one child or dependent and from \$4,800 to \$6,000 for two or more children or dependents. With the cost of child care to parents typically ranging from \$3,000 to \$10,000 for one child, and the cost of adult dependent care even higher, the current limits on qualifying expenses fail to reflect the increasingly high cost of care. 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 one child or dependent to \$4,600 in 2001 dollars, and from \$4,800 for the care of two or more children or dependents to \$9,200 in 2001 dollars. The DCTC provision in the new law, while not restoring the full value of the expense limits in 1981, does restore some of their value and makes the expense limits reflect more of the actual cost of child or dependent care to parents.
- 3. Increases the percentages of qualifying expenses that may be taken as a credit.** The new law increases the maximum percentage of qualifying expenses that can be claimed from the current 30 percent of expenses to 35 percent of expenses. Raising the percentages helps families cover more of their child and dependent care expenses. Moreover, raising the percentages is of special help to low-income families, who are less likely than other families to spend up to the maximum expense limits and are losing a greater proportion of their income to care expenses than other families.
- 4. Increases the adjusted gross income levels at which the percentages of qualifying expenses can be claimed.** The new law raises the AGI at which a family can claim the maximum 35% of its qualifying expenses from the current \$10,000 to \$15,000, and raises the AGI at which a family can claim the minimum 20% of its qualifying expenses from the current \$28,001 to \$43,001. As a result, more families will be able to offset a greater proportion of their child care expenses than under current law.

Under these changes, the maximum credit ranges from \$2,100 for families with AGIs of \$15,000 or less and two or more children or dependents (\$1,050 for one child or dependent) to \$1,200 for families with AGIs of more than \$43,000 and two or more children or dependents (\$600 for one child or dependent).

Comparison of the Maximum Dependent Care Tax Credit Under Current Law with the Maximum Dependent Care Tax Credit Under the New Tax Law 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**	
	Current Law	New Tax Law	Current Law	New Tax Law	Current Law	New Tax Law
\$10,000 or less	30%	35%	\$720	\$1,050	\$1,440	\$2,100
\$11,000	29%	35%	\$696	\$1,050	\$1,392	\$2,100
\$13,000	28%	35%	\$672	\$1,050	\$1,344	\$2,100
\$15,000	27%	35%	\$648	\$1,050	\$1,296	\$2,100
\$17,000	26%	34%	\$624	\$1,020	\$1,248	\$2,040
\$19,000	25%	33%	\$600	\$990	\$1,200	\$1,980
\$21,000	24%	32%	\$576	\$960	\$1,152	\$1,920
\$23,000	23%	31%	\$552	\$930	\$1,104	\$1,860
\$25,000	22%	30%	\$528	\$900	\$1,056	\$1,800
\$27,000	21%	29%	\$504	\$870	\$1,008	\$1,740
\$29,000	20%	28%	\$480	\$840	\$960	\$1,680
\$31,000	20%	27%	\$480	\$810	\$960	\$1,620
\$33,000	20%	26%	\$480	\$780	\$960	\$1,560
\$35,000	20%	25%	\$480	\$750	\$960	\$1,500
\$37,000	20%	24%	\$480	\$720	\$960	\$1,440
\$39,000	20%	23%	\$480	\$690	\$960	\$1,380
\$41,000	20%	22%	\$480	\$660	\$960	\$1,320
\$43,000	20%	21%	\$480	\$630	\$960	\$1,260
more than \$43,000	20%	20%	\$480	\$600	\$960	\$1,200

*The maximum in eligible expenses for one child or dependent under current law is \$2,400; under the new law it is \$3,000.

**The maximum in eligible expenses for two or more children or dependents under current law is \$4,800; under the new law it is \$6,000.

The Impact of the DCTC Expansion on Families

The expansion of the DCTC in the new law will significantly increase the tax assistance available to families with child and dependent care expenses, with the most benefit going to families with modest incomes.

Families with incomes between \$18,000 and \$33,000 and the maximum qualifying child or dependent care expenses will benefit the most from the expansion of the DCTC, with their credits increasing by at least 60 percent. For example, a family with two or more children, \$27,000 in income and \$6,000 in child care expenses would see its credit increase by \$732, from \$1,008 to \$1,740. These families are in special need of additional assistance since most have incomes that are too high to permit them to qualify for a child care subsidy through the Child Care and Development Block Grant, but have incomes that are too low to pay for quality child care. Families with less than \$18,000 in income are likely to receive less or no benefit from the DCTC expansion because they have low or no federal income tax liability and because the credit is not refundable.

Families with incomes between \$33,000 and \$43,000 and the maximum in qualifying child or dependent care expenses will receive between \$600 and \$300 more than they receive under current law if they have two or more children or dependents (between \$300 and \$150 more

if they have one child or dependent). Families with incomes above \$43,000 will receive more than they receive under current law only if they have qualifying dependent care expenses that exceed the current qualifying expense limits. These families will receive \$240 more than they receive under current law if they have two or children or dependents (\$120 more if they have one child or dependent), assuming they have incurred the maximum qualifying expenses.

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