Child and Dependent Care Tax Benefits: How They Work and Who Receives Them

Updated February 1, 2021
Child and Dependent Care Tax Benefits: How They Work and Who Receives Them

Two tax provisions subsidize the child and dependent care expenses of working parents: the child and dependent care tax credit (CDCTC) and the exclusion for employer-sponsored child and dependent care.

The Child and Dependent Care Credit (CDCTC)
The CDCTC is a nonrefundable tax credit that reduces a taxpayer’s federal income tax liability based on child and dependent care expenses incurred by taxpayers who work or are looking for work. The CDCTC is calculated by multiplying the amount of qualifying expenses—a maximum of $3,000 if the taxpayer has one qualifying individual, and up to $6,000 if the taxpayer has two or more qualifying individuals—by the appropriate credit rate. The credit rate varies by the taxpayer’s adjusted gross income (AGI), with a maximum credit rate of 35% that declines, as AGI increases, to 20% for taxpayers with AGI above $43,000 (see the figure below). Even though the credit formula is more generous toward lower-income taxpayers (due to the higher credit rate), many lower-income taxpayers receive little or no credit because the credit is nonrefundable, as illustrated in the table on the next page.

Figure 1. Child and Dependent Care Credit Rate and Amount by Income, 2020

A taxpayer must meet a variety of eligibility criteria in order to claim the CDCTC, including incurring qualifying child and dependent care expenses for one or more qualifying individuals and having earned income.
Child and Dependent Care Tax Benefits: How They Work and Who Receives Them

- **Qualifying expenses** for the CDCTC are generally defined as expenses incurred for the care of a qualifying individual so that a taxpayer (and their spouse, if filing jointly) can work or look for work.
- **A qualifying individual** for the CDCTC is either (1) the taxpayer’s dependent child under 13 years of age for the entire year or (2) the taxpayer’s spouse or dependent who is incapable of caring for themselves.
- **Earned income**: A taxpayer must have earned income to claim the credit. For married couples, both spouses must have earnings unless one is a student or incapable of self-care.

CDCTC data indicate several key aspects of this tax benefit. First, middle- and upper-middle-income taxpayers claim the majority of tax credit dollars. Second, at most income levels the average credit amount is between $500 and $600. Lower-income taxpayers receive less than the average amount. Third, the credit is used almost exclusively for the care of children under 13 years old (as opposed to older dependents). About 12% of taxpayers with children claim the CDCTC. This participation rate is significantly lower for lower-income taxpayers.

<table>
<thead>
<tr>
<th>Adjusted Gross Income (AGI)</th>
<th>% of All Returns</th>
<th>% of All Returns Claiming CDCTC</th>
<th>% of Aggregate CDCTC Dollars</th>
<th>Average Credit Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>$0-under $15K</td>
<td>21.2%</td>
<td>0.3%</td>
<td>0.1%</td>
<td>$124</td>
</tr>
<tr>
<td>$15K-under $25K</td>
<td>12.9%</td>
<td>5.3%</td>
<td>3.1%</td>
<td>$347</td>
</tr>
<tr>
<td>$25K-under $50K</td>
<td>23.7%</td>
<td>22.3%</td>
<td>23.7%</td>
<td>$623</td>
</tr>
<tr>
<td>$50K-under $75K</td>
<td>14.0%</td>
<td>15.2%</td>
<td>15.1%</td>
<td>$583</td>
</tr>
<tr>
<td>$75K-under $100K</td>
<td>8.9%</td>
<td>13.2%</td>
<td>13.8%</td>
<td>$613</td>
</tr>
<tr>
<td>$100K-under $200K</td>
<td>13.8%</td>
<td>30.2%</td>
<td>31.1%</td>
<td>$603</td>
</tr>
<tr>
<td>$200K-under $500K</td>
<td>4.5%</td>
<td>11.6%</td>
<td>11.1%</td>
<td>$564</td>
</tr>
<tr>
<td>$500K+</td>
<td>1.1%</td>
<td>1.9%</td>
<td>2.0%</td>
<td>$611</td>
</tr>
<tr>
<td><strong>All Taxpayers</strong></td>
<td>100.0%</td>
<td>100.0%</td>
<td>100.0%</td>
<td><strong>$586</strong></td>
</tr>
</tbody>
</table>

**Source:** IRS Statistics of Income (SOI) 2018, Table 3.3.

**Exclusion for Employer-Sponsored Child and Dependent Care/Dependent Care FSAs**

In addition to the CDCTC, taxpayers can exclude from their income up to $5,000 of employer-sponsored child and dependent care benefits. Many taxpayers receive the exclusion in the form of a dependent care flexible spending arrangement (FSA). Eligibility rules and definitions of the exclusion are virtually identical to those of the credit. However, one major difference between the exclusion and the CDCTC is that the $5,000 maximum for the exclusion applies irrespective of the number of qualifying individuals. Taxpayers can claim both the exclusion and the tax credit, but not for the same out-of-pocket child and dependent care expenses. In addition, for every dollar of employer-sponsored child and dependent care excluded from income, the taxpayer must reduce the maximum amount of qualifying expenses claimed for the CDCTC.

Data from the Bureau of Labor Statistics (BLS) indicate that about 43% of employees have access to a child and dependent care flexible spending account, while 11% have access to other types of employer-sponsored child care. Overall, these data indicate that these benefits are more widely available to higher-compensated employees at larger establishments. Data from the IRS based on W-2 information returns, however, suggest actual use of these benefits is relatively low. The most recent data available indicate about 1.5 million taxpayers received tax-free employer-sponsored dependent care benefits in 2017. In comparison, during the same year there were about 153 million returns filed, and 6.5 million included the CDCTC.
Contents

Introduction .................................................................................................................................................. 1
Child and Dependent Care Tax Credit ........................................................................................................ 1
   Eligibility for the Credit ................................................................................................................................ 1
       Qualifying Individual ..................................................................................................................................... 2
       Qualifying Expenses ..................................................................................................................................... 2
       Earned Income Test ...................................................................................................................................... 5
       Filing Status .................................................................................................................................................. 5
   Calculating the Credit Amount .................................................................................................................... 5
       Limitations Based on Earned Income ......................................................................................................... 7
Exclusion for Employer-Sponsored Child and Dependent Care Benefits ...................................................... 9
   Dependent Care Flexible Spending Arrangements ......................................................................................... 9
   Interaction Between the CDCTC and Exclusion for Employer-Sponsored Child and Dependent Care ....... 10
Data on the CDCTC .......................................................................................................................................... 11
   Income Level of CDCTC Claimants and Average Credit Amount .............................................................. 12
   Average Credit Amount over Time ............................................................................................................... 13
   Types of Qualifying Individuals Claimed for the Credit ............................................................................. 14
   Percentage of Taxpayers with Children Who Claim the CDCTC ............................................................. 15
Data on the Exclusion of Employer-Sponsored Child and Dependent Care ................................................ 17

Figures

Figure 1. Child and Dependent Care Credit Rate and Amount by Income, 2020 ........................................... 2
Figure 2. Child and Dependent Care Credit Rate and Amount, by Income Level ........................................... 7
Figure 3. Real Aggregate Credit Dollars and Average Credit Amount, 1976-2018 ......................................... 14
Figure 4. Percentage of Taxpayers with Children Who Claim the CDCTC, 2018 ............................................ 16

Tables

Table 1. Distribution of Taxpayers, Credit Dollars, and Average Credit Amount by Adjusted Gross Income (AGI), 2018 ............................................................................................................. 3
Table 2. Typical Expenses that May Qualify for the Child and Dependent Care Credit .................................. 3
Table 3. Credit Rate and Maximum Credit Amount ...................................................................................... 6
Table 4. Distribution of Taxpayers, Credit Dollars, and Average Credit Amount by Adjusted Gross Income (AGI), 2018 ............................................................................................................. 12
Table 5. Distribution of Taxpayers and Credit Dollars by Age of Qualifying Individuals Claimed for CDCTC, 2017 ........................................................................................................................................ 15
Table 6. Percentage of Civilian Workers with Access to Employer-Sponsored Child and Dependent Care, 2020 ................................................................................................................................. 17

Table A-1. Tests for Qualifying Child and Qualifying Relative ...................................................................... 19
Table B-1. Impact of the CDCTC on Income Tax Liability After the TCJA .................................................. 21
Appendixes

Appendix A. What Is a “Dependent” for Tax Purposes? .......................................................... 19
Appendix B. Evaluating the Impact of the CDCTC After the Tax Cuts and Jobs Act (TCJA; P.L. 115-97) .................................................................................................................. 20

Contacts

Author Information ....................................................................................................................... 22
Introduction

There are two tax provisions that subsidize the child and dependent care expenses of working parents: the child and dependent care tax credit (CDCTC) and the exclusion for employer-sponsored child and dependent care. This report provides a general overview of these two tax benefits, focusing on eligibility requirements and benefit calculation. The report also includes summary data on these benefits that highlight several characteristics of claimants.

Child and Dependent Care Tax Credit

The child and dependent care tax credit is a nonrefundable tax credit that reduces a taxpayer’s federal income tax liability based on child and dependent care expenses incurred so the taxpayer can work or look for work. Since the credit (sometimes referred to as the child care credit or the CDCTC) is nonrefundable, the amount of the credit cannot exceed a taxpayer’s federal income tax liability. Taxpayers with little or no federal income tax liability—including many low-income taxpayers—generally receive little if any benefit from nonrefundable credits like the CDCTC.

Eligibility for the Credit

To claim the child and dependent care credit, a taxpayer must meet a variety of eligibility criteria. The taxpayer must have qualifying expenses for a qualifying individual, have earned income, and file taxes with an allowable filing status. These terms are defined briefly below.

- **Qualifying individual**: A qualifying individual for the CDCTC is either (1) the taxpayer’s dependent child under 13 years of age, or (2) the taxpayer’s spouse or dependent who is incapable of caring for themselves.

- **Qualifying expenses**: Qualifying expenses are generally defined as expenses incurred for the care of a qualifying individual so that a taxpayer (and their spouse, if filing jointly) can work or look for work. Payments made to a relative for child and dependent care may be eligible for the credit, unless the relative is the taxpayer’s dependent, child under 19 years old, spouse, or the parent of a qualifying child. Taxpayers claiming the CDCTC generally must provide the name, address, and taxpayer identification number of any person or organization that provides care for a qualifying individual.

- **Earned income**: A taxpayer must have earned income to claim the credit. The amount of qualifying expenses claimed for the credit cannot be greater than the taxpayer’s earned income for the year (or the earned income of the lower-earning spouse in the case of married taxpayers). For married couples filing jointly, both spouses must have earnings unless one is either a student or incapable of self-care.

- **Taxes filed with an allowable filing status**: Taxpayers are generally ineligible for the CDCTC if they file their taxes as “married filing separately.”

---

1 The two tax provisions discussed in this report are available to qualifying families. There is another tax benefit for child care available to employers under Internal Revenue Code (IRC) §45F, which is beyond the scope of this report.

2 IRC §21.
Qualifying Individual

For the purposes of the child and dependent care credit, a qualifying individual is a

- **Young child**: The taxpayer’s dependent child under 13 years of age.³
- **Spouse incapable of caring for themselves**: The taxpayer’s spouse who is physically or mentally incapable of self-care and has lived with the taxpayer for more than half the year. Incapable of self-care means that the individual cannot care for their own hygiene or nutritional needs or requires full-time attention for their own safety or the safety of others.⁴
- **Other dependents incapable of caring for themselves**: An individual who is physically or mentally incapable of self-care (as defined above), lived with the taxpayer for more than half of the year, and is generally the taxpayer’s dependent.⁵ Examples of individuals who may fall into this category include adult children who cannot care for themselves and elderly relatives who live with the taxpayer.

The taxpayer must provide the taxpayer identification number—either a SSN, ITIN, or adoption taxpayer identification number (ATIN)—of each qualifying individual for whom they claim the CDCTC. Failure to do so can result in the denial of the credit.

Qualifying Expenses

Qualifying expenses for the credit are generally defined as expenses for the care of a qualifying individual so that a taxpayer (and their spouse, if filing jointly) can work or look for work.⁶ An expense is not considered work-related merely because a taxpayer paid or incurred the expense while working or looking for work. The purpose of the expense must be to enable the taxpayer to work or look for work. Whether an expense has such a purpose is dependent on the facts and circumstances of each particular case. Qualifying expenses may include costs for a qualifying individual’s care provided in or outside the taxpayer’s home.

In-home Care Expenses

In-home care expenses include costs of care provided in the taxpayer’s home such as the cost of a nanny to look after a child or a housekeeper to look after an elderly parent. The payroll taxes associated with these services, as well as meals and lodging provided to the caregiver as part of their employment, may be qualifying expenses. For household services that are in part for the

---

³ The dependent child must be the taxpayer’s “qualifying child” for purposes of claiming the personal exemption with the additional requirement that the child be 12 years or younger when the qualifying expenses were paid or incurred. For more information on what a “qualifying child” is for the personal exemption, see Appendix A. Although the personal exemption was effectively suspended from 2018 through 2025, the definition of a “qualifying child” for the personal exemption is still in effect.

⁴ 26 C.F.R. §1.21-1(b)(4).

⁵ Technically, the individual must either be (a) the taxpayer’s dependent; or (b) an individual who the taxpayer could have claimed as a dependent except that (1) the individual has gross income that equals or exceeds the personal exemption amount (which would have been $4,300 in 2021 if personal exemptions were not suspended, according to the IRS), or (2) the individual files a joint return, or (3) the individual (or their spouse, if filing jointly) could be claimed as a dependent on another taxpayer’s return.

⁶ For the purposes of the credit, this includes full-time work, part-time work, and self-employment.
care of qualifying individuals and in part for other purposes, generally only the portion for the care of a qualifying individual can be used in determining the credit.\(^7\)

### Out-of-home Care Expenses

Several types of care provided outside the taxpayer’s home may be considered qualifying expenses for the purposes of the credit. To qualify, the care must be provided to the taxpayer’s dependent child under age 13 or another qualifying person who regularly spends at least eight hours each day in the taxpayer’s home (in other words, a nonchild dependent must generally live with the taxpayer even if that dependent spends the day at a care facility). This means, for example, that care provided at a live-in nursing home for a taxpayer’s parent or spouse is not a qualifying expense. Common types of qualifying out-of-home care expenses include the following:

- **Dependent care center**: Care provided at a “dependent care center” can be considered a qualifying expense only if the center complies with all state and local regulations. A dependent care center is defined as a facility that provides care for more than six people (other than those who may reside at the facility) and receives a payment or grant for providing care services.

- **Prekindergarten (Pre-K) education/before- and after-school care**: Expenses for education below the kindergarten level (e.g., nursery school or preschool) may be qualifying expenses for the credit. Treasury regulations provide that expenses for education at the kindergarten level or higher do not qualify for the credit, and neither do summer school or tutoring expenses.\(^8\) However, before- or after-school care of a child in kindergarten or higher grades may be a qualifying expense.

- **Day camp**: Day camp may be a qualifying expense. However, overnight camp is not a qualifying expense.

- **Transportation**: Transportation by a care provider (i.e., not the taxpayer) to take a qualifying individual to or from a place where care is provided may be a qualifying expense. For example, the cost of a nanny driving a child to a day care center may be considered a qualifying expense.\(^9\)

### Table 2. Typical Expenses that May Qualify for the Child and Dependent Care Credit

<table>
<thead>
<tr>
<th>Type of Care</th>
<th>Child</th>
<th>Other Dependent</th>
</tr>
</thead>
<tbody>
<tr>
<td>In-Home Care</td>
<td>• Nannies/Housekeepers</td>
<td>• Nannies/Housekeepers</td>
</tr>
<tr>
<td></td>
<td>• Au Pairs</td>
<td>• Home health aid</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• “Visiting Angels”</td>
</tr>
</tbody>
</table>

---

\(^7\) Treasury regulations provide that a taxpayer does not need to allocate expenses between care for a qualifying individual and other purposes if, for example, other goods and services are provided incidental to and inseparably as part of the care (e.g., meals and snacks provided at day care) or if the expense for the other purpose is small. 26 C.F.R. §1.21(d).

\(^8\) 26 C.F.R. §1.21(d)(5), (7).

\(^9\) According to the Internal Revenue Service, the cost of transportation for a care provider to the taxpayer’s home is not a qualifying expense because the expense is not for the care of a qualifying person. See Internal Revenue Service, *Publication 503 Child and Dependent Care Expenses*, 2016, p. 7.
Child and Dependent Care Tax Benefits: How They Work and Who Receives Them

<table>
<thead>
<tr>
<th>Type of Care</th>
<th>Child</th>
<th>Other Dependent</th>
</tr>
</thead>
<tbody>
<tr>
<td>Outside-the-Home Care</td>
<td>• Child care</td>
<td>• Adult day care</td>
</tr>
<tr>
<td></td>
<td>• Nursery school</td>
<td></td>
</tr>
<tr>
<td></td>
<td>• Preschool</td>
<td></td>
</tr>
<tr>
<td></td>
<td>• Before- or after-school care for a child</td>
<td></td>
</tr>
<tr>
<td></td>
<td>in kindergarten or higher grade</td>
<td></td>
</tr>
<tr>
<td></td>
<td>• Day camp (overnight camp is NOT a</td>
<td></td>
</tr>
<tr>
<td></td>
<td>qualifying expense)</td>
<td></td>
</tr>
</tbody>
</table>

Source: Congressional Research Service based on information found in 26 C.F.R. §1.21.

Note: The expense must meet all other criteria, including being paid or incurred so that the taxpayer can work or look for work. Whether an expense actually qualifies for the credit will depend on the facts and circumstances of each particular case.

Rules Regarding Payments Made to Relatives Who Provide Care

Payments made to a relative for child and dependent care are generally eligible for the credit. However, payments made to the following types of relatives would not be eligible for the CDCTC:

- **Taxpayer’s dependent**: The relative is the taxpayer’s dependent.\(^{10}\)
- **Child under 19 years old**: The relative is the taxpayer’s child and under 19 years old (irrespective of whether they are the taxpayer’s dependent).
- **Spouse**: The relative is the taxpayer’s spouse at any time during the year.
- **Parent of a qualifying child**: The relative is the parent of the qualifying child for whom the expenses are incurred.\(^{11}\)

Care Provider Identification (ID) Test

Taxpayers claiming the CDCTC generally must provide the name, address, and taxpayer identification number of any individual or entity that provides care for a qualifying individual, or the IRS may deny the taxpayer’s claim for the credit. Taxpayer identification numbers for individuals are either Social Security numbers (SSNs) or individual taxpayer identification numbers (ITINs). Entities’ taxpayer identification numbers are generally employer identification numbers (EINs). Taxpayers are only required to provide the name and address (i.e., not the ITIN) of a care provider that is a tax-exempt 501(c)(3) organization. If a care provider refuses to provide information (e.g., an individual does not wish to provide the taxpayer with their SSN), the taxpayer can generally still claim the credit if they exercise due diligence in attempting to obtain the information and keep a record of their attempt to secure this information.\(^{12}\)

---

\(^{10}\) The taxpayer or spouse is eligible to claim the relative as a dependent for the personal exemption. The personal exemption (IRC §151) and the definition of a dependent eligible for the personal exemption (IRC §152) remain in the current Internal Revenue Code. However, from 2018 through the end of 2025, the personal exemption amount is zero.

\(^{11}\) In this case, the qualifying child is defined specifically as the taxpayer’s dependent child under the age of 13.

\(^{12}\) Generally, a taxpayer will obtain the identifying information from a child and dependent care provider by asking the provider to fill out IRS Form W-10. Taxpayers then provide the information to the IRS by filing out the Form 2441, which is used to claim the credit. According to the IRS, if the care provider refuses to provide a taxpayer identification number or other information, the taxpayer should “Claim the childcare expenses on Form 2441, Child and Dependent Care Expenses, and provide the care provider’s information you have available (such as name and address). Write ‘See Attached Statement’ in the columns missing information. Explain on the attached statement that you requested the


Earned Income Test

In order to claim the credit, a taxpayer (and if married, their spouse) must have earned income during the year. For taxpayers who do not work as a result of the taxpayer (or if married, their spouse) being incapable of self-care or a full-time student, special rules apply in calculating their annual earned income (see “Deemed Income in Cases Where an Individual is Incapable of Self-Care or a Full-Time Student”).

Earned income includes wages, salaries, tips, other taxable employee compensation, and net earnings from self-employment. In general only earned income that is taxable (i.e., wages, salaries, and tip income) is considered for this test. Hence nontaxable compensation like foreign earned income and Medicaid waiver payments does not count as earned income. However, taxpayers can elect to include nontaxable combat pay as earned income when claiming the credit.

Filing Status

Generally, taxpayers who file their federal income taxes as single, head of household, or married filing jointly are eligible to claim the credit,13 while those who file using the status “married filing separately” are ineligible for the credit. However, in certain cases taxpayers who use the filing status “married filing separately” may be eligible for the credit if they live apart from their spouse for more than half the year and care for a qualifying individual.14 (Spouses who are legally separated are generally not considered married for tax purposes.)

Calculating the Credit Amount

The amount of the CDCTC is calculated by multiplying the amount of qualifying expenses, after applying the dollar limits and earned income limits (discussed below), by the appropriate credit rate. Since the credit is nonrefundable, the actual amount of the credit claimed cannot exceed the taxpayer’s income tax liability.

The credit rate used to calculate the credit is based on the taxpayer’s adjusted gross income (AGI).15 The credit rate is set at a maximum of 35% for taxpayers with AGI under $15,000. The credit rate then declines by one percentage point for each $2,000 (or fraction thereof) above $15,000 of AGI, until the credit rate reaches its statutory minimum of 20% for taxpayers with AGI over $43,000. This credit rate schedule is illustrated in Table 3. The AGI brackets associated with each credit rate are not adjusted annually for inflation and have been unchanged since 2001 (when they were last changed by legislation).

---

13 A qualifying widow(er) with a dependent child is also an eligible filing status to claim the credit.
14 Specifically, a married individual living apart from their spouse may be eligible for the credit if they fulfill the following requirements: (1) file a separate return from their spouse; (2) have a qualifying individual (for the purposes of the credit) who lives with them for more than half the year in their home; (3) pay more than half the cost of maintaining their home for the year; (4) and their spouse does not live with them in their home for the last six months of the year.
15 Adjusted gross income, as defined in IRC §62. For more information, see CRS Report RL30110, Federal Individual Income Tax Terms: An Explanation, by Mark P. Keightley.
### Table 3. Credit Rate and Maximum Credit Amount

By Adjusted Gross Income (AGI)

<table>
<thead>
<tr>
<th>Adjusted Gross Income (AGI) ( &gt; - $)</th>
<th>Credit Rate</th>
<th>Maximum Statutory Credit Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td>One Child ($3,000 max expenses)</td>
</tr>
<tr>
<td>$0-$15,000</td>
<td>35%</td>
<td>$1,050</td>
</tr>
<tr>
<td>$15,000 - $17,000</td>
<td>34%</td>
<td>$1,020</td>
</tr>
<tr>
<td>$17,000 - $19,000</td>
<td>33%</td>
<td>$990</td>
</tr>
<tr>
<td>$19,000 - $21,000</td>
<td>32%</td>
<td>$960</td>
</tr>
<tr>
<td>$21,000 - $23,000</td>
<td>31%</td>
<td>$930</td>
</tr>
<tr>
<td>$23,000 - $25,000</td>
<td>30%</td>
<td>$900</td>
</tr>
<tr>
<td>$25,000 - $27,000</td>
<td>29%</td>
<td>$870</td>
</tr>
<tr>
<td>$27,000 - $29,000</td>
<td>28%</td>
<td>$840</td>
</tr>
<tr>
<td>$29,000 - $31,000</td>
<td>27%</td>
<td>$810</td>
</tr>
<tr>
<td>$31,000 - $33,000</td>
<td>26%</td>
<td>$780</td>
</tr>
<tr>
<td>$33,000 - $35,000</td>
<td>25%</td>
<td>$750</td>
</tr>
<tr>
<td>$35,000 - $37,000</td>
<td>24%</td>
<td>$720</td>
</tr>
<tr>
<td>$37,000 - $39,000</td>
<td>23%</td>
<td>$690</td>
</tr>
<tr>
<td>$39,000 - $41,000</td>
<td>22%</td>
<td>$660</td>
</tr>
<tr>
<td>$41,000 - $43,000</td>
<td>21%</td>
<td>$630</td>
</tr>
<tr>
<td>$43,000+</td>
<td>20%</td>
<td>$600</td>
</tr>
</tbody>
</table>

**Source:** IRS Publication 503 and Internal Revenue Code (IRC) §21.

**Note:** None of the parameters of the child and dependent care tax credit are adjusted for inflation.

The maximum amount of expenses that can be multiplied by the credit rate is $3,000 if the taxpayer has one qualifying individual and $6,000 if the taxpayer has two or more qualifying individuals. These amounts are not adjusted annually for inflation, and have not changed since 2001 (when they were last changed by legislation). For taxpayers with two or more qualifying individuals, the maximum expense threshold is per taxpayer irrespective of actual child and dependent care expenses associated with each qualifying individual. Hence, if a taxpayer has two qualifying individuals, and they have incurred no qualifying expenses for one individual and $6,000 for the other, they can claim a credit based on up to $6,000 of qualifying expenses.

Even though the credit formula—due to the higher credit rate—is more generous toward lower-income taxpayers, many lower-income taxpayers receive little or no credit since the credit is nonrefundable, as illustrated in Figure 2.
Figure 2. Child and Dependent Care Credit Rate and Amount, by Income Level

Married couple with two qualifying children and $6,000 of qualifying expenses

**Limitations Based on Earned Income**

There are limits on the amount of annual work-related expenses that can be used to calculate the credit, in addition to the maximum dollar amount of qualifying expenses limit that was previously discussed. Specifically, qualifying expenses used to claim the credit cannot be more than

- the taxpayer’s earned income for the year (for unmarried taxpayers) or
- the lower-earning spouse’s earned income for the year (for married taxpayers).
For example, if an unmarried taxpayer had two qualifying individuals and $6,000 of qualifying expenses but $4,000 of earned income, the maximum amount of expenses that could be applied toward the credit would be $4,000.

If an individual (either an unmarried taxpayer or each spouse among married taxpayers) does not have earnings for each month of a calendar year, they can calculate their total earned income for the year by summing up their earnings for those months in which they do have earned income. (Among married taxpayers, both spouses may need to calculate their earned income for the year to determine which spouse is the lower-earning spouse. Total expenses cannot be more than the earned income of the lower-earning spouse.) For example, if an unmarried taxpayer (or the lower-earning spouse of a two-earner couple) earned $500 for three months of the year, and did not work the remaining nine months of the year, their earned income for the purposes of the earned income limitation would be $1,500 and they could not use more than $1,500 of child and dependent care when calculating the credit.

**Deemed Income in Cases Where an Individual is Incapable of Self-Care or a Full-Time Student**

If an individual (either an unmarried taxpayer or one spouse among married taxpayers) has little or no earnings for each month of a calendar year because they are incapable of self-care or are a full-time student, they will calculate their earned income differently. For months in which an individual does not have earnings and is also incapable of self-care or a full-time student, their earned income for that month equals a “deemed” amount (instead of equaling zero). Specifically, their earned income is “deemed” to be $250 per month if they have one qualifying individual or $500 per month if they have two or more qualifying individuals.\(^\text{16}\) If an individual—either an unmarried taxpayer, or if married, the lower-earning spouse of a two-earner couple—is either a full-time student or not able to care for themselves for the entire year, they may be eligible (depending on their actual expenses) to apply the maximum amount of expenses when calculating the credit. Specifically, $250 and $500 multiplied by 12 months will result in an annual amount of earned income of $3,000 if they have one qualifying individual or $6,000 if they have two or more qualifying individuals—the statutory maximum amount of qualifying expenses for the credit.

For married couples, only one spouse in any given month can be “deemed” to have earned income ($250 per month for one qualifying individual or $500 per month for two or more qualifying individuals) as a result of being incapable of self-care or being a full-time student. This implies that if both spouses are incapable of self-care or full-time students simultaneously for every month in a year, the couple will ultimately be ineligible for the credit. In this scenario only one spouse would be considered as having earned income, and hence the couple would be ineligible for the credit.

\(^{16}\) For example, if an unmarried taxpayer earned $500 for three months of the year, and did not work the remaining nine months of the year because they were a full-time student and they had one qualifying individual, their earned income for the purposes of the earned income limitation would be $1,500 ($500 x three months) plus $2,250 ($250 x nine months) which equals $3,750. Since this is more than the statutory maximum of $3,000 per one qualifying individual, the maximum amount of $3,000 is applicable.
Exclusion for Employer-Sponsored Child and Dependent Care Benefits

In addition to the CDCTC, workers can exclude from their wages up to $5,000 of employer-sponsored child and dependent care benefits. Since the value of these benefits is excluded from wages, it is not subject to income or payroll taxes. As a result of the exclusion, workers owe less in income and payroll taxes. For example, a worker subject to a 22% income tax rate (and 7.65% payroll tax rate) who has $1,000 of employer-sponsored dependent care expenses would save $296.50 in federal taxes from the exclusion rather than paying out of pocket (i.e., with after-tax dollars).

The exclusion of employer-sponsored care uses similar definitions and eligibility rules as the CDCTC. However, one key difference is that when a worker uses the exclusion, the $5,000 maximum applies irrespective of the number of qualifying individuals. For example, a family with one qualifying child and a family with two qualifying children could both use the exclusion to set aside up to $5,000 on a pretax basis for child care. With the child and dependent care credit, there are separate limits based on the number of qualifying individuals ($3,000 for one qualifying individual, $6,000 for two or more qualifying individuals). In addition, married taxpayers who file their returns as married filing separately are eligible to benefit from this exclusion, whereas these married separate filers are ineligible for the CDCTC.

Employer-sponsored child and dependent care benefits can be provided in various forms, including

- direct payments by an employer to a child care or adult day care provider,
- on-site child or dependent care offered by an employer,
- employer reimbursement of employee child care costs, and
- flexible spending arrangements (FSAs) that allow employees to set aside a portion of their salary on a pretax basis (i.e., under a “cafeteria plan”) to be used for qualifying child and dependent care expenses.

Survey data from the Bureau of Labor Statistics suggest that dependent care FSAs are more frequently offered to workers than are other forms of employer-sponsored dependent care (comparable IRS data are not available).

Dependent Care Flexible Spending Arrangements

Dependent care FSAs must meet the requirements of both Internal Revenue Code (IRC) Section 129, which governs employer-sponsored dependent care benefits broadly, and IRC Section 125, which governs cafeteria plans. As with most other benefits offered as part of a cafeteria plan,

---

17 IRC §129. Among other criteria, employer-sponsored child and dependent care must be provided under a written plan which meets certain conditions.

18 This total includes $220 in federal income taxes and $76.50 in Social Security and Medicare payroll taxes.

19 IRC §21(c).

20 Bureau of Labor Statistics, National Compensation Survey: Employee Benefits in the United States, March 2019, Tables 39 and 40. For purposes of this survey, employer-sponsored child care is defined as a workplace program that “provides for either the full or partial cost of caring for an employee’s children in a nursery, day care center, or a baby sitter in facilities either on or off the employer’s premises.”
workers typically determine the amount they wish to contribute to a dependent care FSA at the beginning of a plan year. Plan years are usually annual periods during which workers may contribute to and be reimbursed from an FSA. Once a worker has set the amount they wish to contribute to an FSA for a plan year, changes are allowed only in limited circumstances (like the birth of a child or marriage).

Dependent care FSA contributions are subject to a “use or lose” rule, whereby workers forfeit any unused contributions remaining in their FSA at the end of the plan year. The “use or lose” rule ensures that workers cannot use an FSA to defer compensation (and the taxes paid on that compensation) to a future date, which is generally prohibited under IRC Section 125.

**Interaction Between the CDCTC and Exclusion for Employer-Sponsored Child and Dependent Care**

Taxpayers can claim both the exclusion and the tax credit, but not for the same out-of-pocket child and dependent care expenses. For every pretax (i.e., excluded) dollar of employer-sponsored child and dependent care, the taxpayer must reduce the maximum amount of qualifying expenses for the CDCTC (up to $3,000 for one child, $6,000 for two or more children). For example, if a family had one child, $10,000 in annual child care expenses, and contributed $5,000 annually to a dependent care FSA, the family could not claim the CDCTC. The amount of pretax dollars in the FSA ($5,000) would eliminate the maximum amount of expenses that could be applied to the credit ($3,000). If in the same year, the family had a second child, and all else remained the same, they could claim $5,000 tax-free through their FSA and claim the remaining allowable expense of $1,000 ($6,000 maximum for two or more children, minus $5,000 in the FSA) for the CDCTC.

---

21 In response to the COVID-19 pandemic, Congress provided additional temporary flexibilities for dependent care FSAs as part of P.L. 116-260. Specifically, the law allows employers to permit unused funds in 2020 and 2021 (i.e., FSAs with 2020 and 2021 “plan years”) to be carried over to the next year (i.e., unused funds in a 2020 dependent care FSA could be carried over to 2021 and unused funds from 2021 could be carried over to 2022). The law also allows employers that provide a grace period for using unused funds to extend such grace period in 2020 and 2021 from 2.5 to 12 months (i.e., if there are unused balances in a plan that ends in 2020 or 2021, they can be used for up to 12 additional months after the end of the plan year). In addition, P.L. 116-260 provides special age rules for dependent care FSA coverage of otherwise qualifying children who exceeded the current age limit (under 13 years old) during the pandemic. Finally, the law allows employers to provide employees with the opportunity to make midyear, prospective FSA contribution changes for plans ending in 2021.

22 Employer-sponsored child and dependent care must be provided under a written plan which meets certain conditions. Note that under a cafeteria plan, employees have the choice not to accept the exclusion, and hence could apply additional child and dependent care expenses toward the credit. However, in practice, most taxpayers will receive a greater marginal benefit from the exclusion than the credit. For example, if a taxpayer has $100,000 of adjusted gross income (AGI) and is subject to a marginal income tax rate of 25% and 7.65% of payroll taxes, they would reduce their tax bill by 32.65 (25+7.65) cents for every dollar put in the FSA. In comparison, the credit would lower their tax bill by 20 cents for every dollar applied toward the credit.
A Brief Overview of Major Legislative Changes to Child and Dependent Care Tax Benefits

1976: P.L. 94-455 enacted the nonrefundable child and dependent care credit. Before the enactment of the child and dependent care credit, "taxpayers could claim as an itemized deduction certain expenses incurred for the care of a child or a disabled dependent or spouse up to $4,800 a year. The maximum deduction was reduced by one dollar for every two dollars of income in excess of $35,000." Joint Committee on Taxation, Tax Legislation Enacted in the 94th Congress, October 1976, JCS-31-76, pp. 123-124. This itemized deduction was originally enacted in 1954. P.L. 94-455 converted the deduction to a credit.

1981: P.L. 97-34 created the current "sliding-scale" credit rate whereby the credit rate decreases as income increases. The sliding scale began at 30% for taxpayers with adjusted gross income of $10,000 or less, with the rate reduced by one percentage point for each $2,000 (or fraction thereof) above $10,000 until the lowest rate of 20% was reached at $28,000 of income. The law also increased the maximum expenditures from $2,000 to $2,400 for one qualifying individual and from $4,000 to $4,800 for two or more qualifying individuals. The law also enacted the exclusion for employer-sponsored child and dependent care.

1986: P.L. 99-514 limited the dollar amount of the exclusion to $5,000 per taxpayer.

1988: P.L. 100-485 created a dollar-for-dollar reduction in the amount of expenses eligible for the CDCTC for amounts excluded under an employer-sponsored dependent care assistance program (see "Interaction Between the CDCTC and Exclusion for Employer-Sponsored Child and Dependent Care").

2001: P.L. 107-16 modified the sliding scale credit rate. The top credit rate was increased from 30% to 35% and the income level for this credit rate was increased from $10,000 to $15,000. The law also increased the maximum expenditures from $2,400 to $3,000 for one qualifying individual and from $4,800 to $6,000 for two or more qualifying individuals. These amounts were not indexed for inflation. These were temporary changes scheduled to expire at the end of 2010.


2012: P.L. 112-240 made the 2001 changes permanent.

Data on the CDCTC

The aggregate data for the child and dependent care credit illustrate several key aspects of this tax benefit.

- **Income level of CDCTC claimants**: Middle- and upper-middle-income taxpayers claim the majority of tax credit dollars.

- **Average credit amount**: At most income levels the average credit amount is between $500 and $600. Lower-income taxpayers receive less than the average amount.

- **Average credit amount over time**: Over the past 30 years, the average real (i.e., adjusted for inflation) credit amount per taxpayer has steadily declined and lost about one-third of its value.

- **Types of qualifying individuals claimed for the credit**: While the credit is available for the care expenses of nonchild dependents (disabled family members or elderly parents), the credit is used almost exclusively for the care of children under 13 years old.

- **Percentage of taxpayers with children that claim the CDCTC**: While the credit is claimed almost exclusively for the care of children, on average 12% of

---

23 Before the enactment of the child and dependent care credit, “taxpayers could claim as an itemized deduction certain expenses incurred for the care of a child or a disabled dependent or spouse up to $4,800 a year. The maximum deduction was reduced by one dollar for every two dollars of income in excess of $35,000.” Joint Committee on Taxation, Tax Legislation Enacted in the 94th Congress, October 1976, JCS-31-76, pp. 123-124. This itemized deduction was originally enacted in 1954. P.L. 94-455 converted the deduction to a credit.

taxpayers with children claim the credit. This participation rate is significantly lower for lower-income taxpayers.

**Income Level of CDCTC Claimants and Average Credit Amount**

The CDCTC tends to be claimed by middle- and upper-middle-income taxpayers. Comparatively few claimants are low-income or very high-income, as illustrated in Table 4. For most taxpayers, the average credit amount is between $500 and $600, although low-income taxpayers that do claim the CDCTC tend to receive a smaller tax credit. Few lower-income taxpayers benefit from the CDCTC, since the credit is nonrefundable. As previously discussed, a nonrefundable credit is limited to the taxpayer’s income tax liability. Hence, taxpayers with little to no income tax liability—including low-income taxpayers—receive little to no benefit from nonrefundable credits like the CDCTC.

For some taxpayers, especially higher-income taxpayers, the amount of their CDCTC will be affected by the amount of tax-free employer-sponsored child care they receive. If a taxpayer’s marginal tax rate is greater than the applicable credit rate, the taxpayer will receive a larger tax savings from claiming the exclusion rather than the credit (in addition, the exclusion lowers their payroll taxes). For example, $100 of employer-sponsored child care saved in an FSA would lower a taxpayer’s income tax bill by $35 if they were in the 35% tax bracket.\(^{25}\) The tax savings associated with applying that $100 to the CDCTC would, by contrast, be $20. Hence, if employer-sponsored child care is offered by their employer, a taxpayer may claim this benefit first and apply any remaining eligible expenses (if applicable)\(^{26}\) toward the credit, lowering their credit amount in comparison to if the exclusion was not available.

<table>
<thead>
<tr>
<th>Adjusted Gross Income (AGI)</th>
<th>% of All Returns</th>
<th>% of All Returns Claiming CDCTC</th>
<th>% of Aggregate CDCTC Dollars</th>
<th>Average Credit Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>$0-under $15K</td>
<td>21.2%</td>
<td>0.3%</td>
<td>0.1%</td>
<td>$124</td>
</tr>
<tr>
<td>$15K-under $25K</td>
<td>12.9%</td>
<td>5.3%</td>
<td>3.1%</td>
<td>$347</td>
</tr>
<tr>
<td>$25K-under $50K</td>
<td>23.7%</td>
<td>22.3%</td>
<td>23.7%</td>
<td>$623</td>
</tr>
<tr>
<td>$50K-under $75K</td>
<td>14.0%</td>
<td>15.2%</td>
<td>15.1%</td>
<td>$583</td>
</tr>
<tr>
<td>$75K-under $100K</td>
<td>8.9%</td>
<td>13.2%</td>
<td>13.8%</td>
<td>$613</td>
</tr>
<tr>
<td>$100K-under $200K</td>
<td>13.8%</td>
<td>30.2%</td>
<td>31.1%</td>
<td>$603</td>
</tr>
<tr>
<td>$200K-under $500K</td>
<td>4.5%</td>
<td>11.6%</td>
<td>11.1%</td>
<td>$564</td>
</tr>
<tr>
<td>$500K+</td>
<td>1.1%</td>
<td>1.9%</td>
<td>2.0%</td>
<td>$611</td>
</tr>
<tr>
<td><strong>All Taxpayers</strong></td>
<td><strong>100.0%</strong></td>
<td><strong>100.0%</strong></td>
<td><strong>100.0%</strong></td>
<td><strong>$586</strong></td>
</tr>
</tbody>
</table>

*Source: IRS Statistics of Income (SOI) 2018, Table 3.3.*

Some low- and moderate-income taxpayers may have received a smaller benefit from the CDCTC after enactment of P.L. 115-97 (often referred to as the Tax Cuts and Job Act or TCJA), which went into effect in 2018. Although the law did not directly modify CDCTC, other changes

---

\(^{25}\) In 2018, a married couple filing jointly would be in the 35% bracket if their taxable income was over $400,000 but not over $600,000. This taxpayer’s applicable credit rate for the CDCTC would be 20%.

\(^{26}\) If a taxpayer has one child, and receives $5,000 in tax-free employer-sponsored child care from their employer, they will have $0 of qualifying expenses for the CDCTC.
made by the law—specifically those made to a different credit, the child tax credit (CTC)—effectively mean that some low- and moderate-income families owe the same amount of income taxes with or without the CDCTC. In other words, some low- and moderate-income families may no longer receive a net benefit from the credit. The Tax Policy Center found that between 2017 and 2018 the share of taxpayers with incomes between $20,000 and $30,000 who benefited from the CDCTC fell from 5% to 2%. Similarly, for taxpayers with income between $30,000 and $40,000, the share of taxpayers who benefited from the CDCTC fell from 9% to 6%. For more information, see Appendix B.

**Average Credit Amount over Time**

The CDCTC was enacted in 1976. Subsequent legislative changes increased the size of the credit by increasing the maximum amount of allowable expenses and the credit rate (see “A Brief Overview of Major Legislative Changes to Child and Dependent Care Tax Benefits”).

Between 1976 and 1988, the average credit amount and aggregate amount of the credit steadily increased in real (i.e., inflation adjusted) dollars, as illustrated in Figure 3. Beginning in 1989, both the average and aggregate credit amount began to decline, with a sharp drop in the aggregate amount claimed. This decline over such a short time period may be due to measures adopted by the IRS to reduce improper claims of tax benefits, as well as legislative changes. First, beginning in 1987, taxpayers were required to provide the Social Security numbers (SSNs) of dependents on their federal income tax returns. Second, beginning in 1989, taxpayers had to provide the caregiver’s taxpayer ID number (generally for individuals, their SSNs). According to one IRS researcher, “What probably happened in most cases is that people were paying their babysitter off the books, and their babysitter would not provide their Social Security numbers or go on the books, so the family had to choose between finding a new babysitter, or giving up the credit.”

Finally, in 1988, Congress enacted a provision as part of P.L. 100-485 (see “A Brief Overview of Major Legislative Changes to Child and Dependent Care Tax Benefits”) that required taxpayers to reduce the amount of expenses applied to the credit by amounts received under the exclusion. This may have resulted in a substantial reduction in the amount of expenses many taxpayers applied toward the credit, and hence a smaller credit.

Since 1988, the real average value of the CDCTC has steadily fallen (see Figure 3). This trend may be driven by several factors. First, as previously discussed, the parameters of the credit, including the maximum amount of qualifying expenses and the income brackets for each applicable credit rate (see Table 3) are not indexed for inflation. The last time the credit rate and maximum level of expenses was increased was in 2001 as part of the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA; P.L. 107-16). Before EGTRRA the parameters of the credit had not been increased since 1981 (see “A Brief Overview of Major Legislative Changes to Child and Dependent Care Tax Benefits”). If the credit as enacted in 1976 had been adjusted annually for inflation, the $800 maximum credit amount for two or more children in

---

27 In 1987, 7 million fewer children were claimed as dependents on federal income tax returns according to data summarized by Jeffrey Liebman. Jeffrey Liebman, “Who are the Ineligible EITC Recipients?” *National Tax Journal*, vol. 53, no. 4 (December 2000), p. 1171.

28 P.L. 100-485.

1976 would have equaled more than $3,500 in 2018.\textsuperscript{30} Hence, inflation has eroded a substantial amount of the credit’s value.

**Figure 3. Real Aggregate Credit Dollars and Average Credit Amount, 1976-2018**

Source: IRS Statistics of Income Table 3.3 and the Bureau of Labor Statistics CPI-U.

Note: Nominal data were adjusted for inflation to 2018 dollars using the CPI-U.

**Types of Qualifying Individuals Claimed for the Credit**

Administrative data from the Internal Revenue Service, summarized in Table 5, indicate that the CDCTC is used primarily for the care expenses of children under 13 years old.

\textsuperscript{30} This amount was calculated using the inflation calculator from the Bureau of Labor Statistics. This calculator is available at https://data.bls.gov/cgi-bin/cpicalc.pl.
Table 5. Distribution of Taxpayers and Credit Dollars by Age of Qualifying Individuals Claimed for CDCTC, 2017

<table>
<thead>
<tr>
<th>Age of Qualifying Individual(s)</th>
<th>Tax Returns</th>
<th>Total Credit Dollars</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Number</td>
<td>Percentage</td>
</tr>
<tr>
<td>Exclusively under 13 years old</td>
<td>6,153,557</td>
<td>95.1%</td>
</tr>
<tr>
<td>Exclusively 13 years old or older</td>
<td>159,184</td>
<td>2.5%</td>
</tr>
<tr>
<td>Mix of over and under 13 years old</td>
<td>156,495</td>
<td>2.4%</td>
</tr>
<tr>
<td>Total</td>
<td>6,469,236</td>
<td>100.0%</td>
</tr>
</tbody>
</table>

Source: Data provided to CRS from the Internal Revenue Service, Statistics of Income (SOI). Data available to congressional clients from the authors upon request.

Notes: Items may not sum due to rounding.

Few taxpayers claim the CDCTC for older dependents. This may be a result of several factors. First, most dependents are children. For example, in 2017, over 83 million dependents were children, while approximately 11 million were older (including parents). Second, the definition of qualifying expenses excludes many expenses incurred for older dependents. For example, if older dependents are being cared for by a stay-at-home taxpayer, any expenses incurred for their care will not be considered qualifying expenses (because the caregiver is not considered to be working or looking for work). In addition, certain eldercare expenses, like nursing home expenses, are not considered qualifying expenses for the CDCTC because the individual being cared for is not living with the taxpayer for at least eight hours each day (see “Qualifying Expenses”).

Percentage of Taxpayers with Children Who Claim the CDCTC

Data from the Tax Policy Center (TPC) indicate that on average about 12% of taxpayers with children claim the child and dependent care credit, as illustrated in Figure 4. A greater proportion of higher-income taxpayers with children claim the credit than lower-income taxpayers. One possible explanation for why relatively few families with children claim the credit is that they do not have child care expenses (perhaps because their children are older). Another possible explanation is that care expenses that are incurred are not considered qualifying expenses for the credit. For example, families with a stay-at-home parent would generally be ineligible for the CDCTC. In addition, families paying an older child to look after a younger child would not be able to claim those expenses for the CDCTC. Finally, families eligible for the exclusion and with only one child may benefit more from the exclusion for employer-provided dependent care and simply not claim the CDCTC.

31 Internal Revenue Service, Individual Income Tax Returns Line Item Estimates, 2017, Publication 1304, Table 2.3.

32 It is important to note that children as defined by the Tax Policy Center in this example are children for whom that taxpayer can claim a dependent exemption or for whom that taxpayer can claim the child tax credit or earned income tax credit (EITC). Some of these children will not be qualifying individuals for the purposes of the CDCTC, because, for example, they are 13 years or older.
Figure 4. Percentage of Taxpayers with Children Who Claim the CDCTC, 2018

By Income Quintile

<table>
<thead>
<tr>
<th>Quintile</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Lowest 20%</td>
<td>0.2%</td>
</tr>
<tr>
<td>Second 20%</td>
<td>8.1%</td>
</tr>
<tr>
<td>Middle 20%</td>
<td>15.1%</td>
</tr>
<tr>
<td>Fourth 20%</td>
<td>20.1%</td>
</tr>
<tr>
<td>Top 20%</td>
<td>18.2%</td>
</tr>
<tr>
<td>All Taxpayers</td>
<td>11.8%</td>
</tr>
</tbody>
</table>


Notes: Each quintile contains 20% of the population ranked by expanded cash income (ECI).\(^{33}\) Percentages are rounded to the nearest whole number. For purposes of this figure, taxpayers with children may include certain children who are not qualifying individuals for the CDCTC, including children 13 years old and older.

Fewer lower-income families with children benefit from the CDCTC, because the credit is nonrefundable. A nonrefundable credit is limited to the taxpayer’s income tax liability. Taxpayers with little to no income tax liability, including low-income taxpayers, hence receive little to no benefit from nonrefundable credits.

\(^{33}\) For distributional analyses, the Tax Policy Center (TPC) uses an income concept called “expanded cash income” (ECI). ECI is a broad measure of pretax income, and is used both to rank tax units in distribution tables and to calculate effective tax rates. According to the TPC, “We define ECI as adjusted gross income (AGI) plus: above-the-line adjustments (e.g., IRA deductions, student loan interest, self-employed health insurance deduction, etc.), employer-paid health insurance and other nontaxable fringe benefits, employee and employer contributions to tax-deferred retirement savings plans, tax-exempt interest, nontaxable Social Security benefits, nontaxable pension and retirement income, accruals within defined benefit pension plans, inside buildup within defined contribution retirement accounts, cash and cash-like (e.g., SNAP) transfer income, employer’s share of payroll taxes, and imputed corporate income tax liability.” For more information, see Tax Policy Center, TPC’s Microsimulation Model FAQ, http://www.taxpolicycenter.org/resources/tpcs-microsimulation-model-faq. The income percentile classes used in this table are based on the income distribution for the entire population and contain an equal number of people, not tax units. The incomes used are adjusted for family size by dividing by the square root of the number of people in the tax unit. The resulting percentile breaks are (in 2018 dollars): 20% $25,100; 40% $49,300; 60% $85,900; 80% $153,300.
Data on the Exclusion of Employer-Sponsored Child and Dependent Care

Survey data from the Bureau of Labor Statistics (BLS) indicate that about 43% of employees have access to child and dependent care flexible spending accounts, while 11% have access to employer-sponsored child care. The survey also found that availability of these benefits differed based on a variety of factors, including the average wage paid to the employee and size of employer, as summarized in Table 6. Overall, the data indicate that these benefits are more widely available to more highly compensated employees and employees at larger establishments.

### Table 6. Percentage of Civilian Workers with Access to Employer-Sponsored Child and Dependent Care, 2020

<table>
<thead>
<tr>
<th>Average Wage&lt;sup&gt;b&lt;/sup&gt;</th>
<th>Access to Dependent Care Flexible Spending Account (FSA)&lt;sup&gt;a&lt;/sup&gt;</th>
<th>Access to Employer-Provided Child Care</th>
</tr>
</thead>
<tbody>
<tr>
<td>Lowest 10%</td>
<td>13%</td>
<td>5%</td>
</tr>
<tr>
<td>Lowest 25%</td>
<td>20%</td>
<td>5%</td>
</tr>
<tr>
<td>Second 25%</td>
<td>40%</td>
<td>8%</td>
</tr>
<tr>
<td>Third 25%</td>
<td>52%</td>
<td>13%</td>
</tr>
<tr>
<td>Highest 25%</td>
<td>65%</td>
<td>20%</td>
</tr>
<tr>
<td>Highest 10%</td>
<td>68%</td>
<td>23%</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Size of Employer</th>
<th>Access to Dependent Care Flexible Spending Account (FSA)&lt;sup&gt;a&lt;/sup&gt;</th>
<th>Access to Employer-Provided Child Care</th>
</tr>
</thead>
<tbody>
<tr>
<td>1-49 workers</td>
<td>21%</td>
<td>5%</td>
</tr>
<tr>
<td>50-99 workers</td>
<td>37%</td>
<td>7%</td>
</tr>
<tr>
<td>100-499 workers</td>
<td>51%</td>
<td>9%</td>
</tr>
<tr>
<td>500 workers or more</td>
<td>71%</td>
<td>25%</td>
</tr>
</tbody>
</table>


**Notes:** These results are for civilian employees only.

- These data reflect access to FSAs provided as part of a Section 125 cafeteria plan.
- Surveyed occupations are classified into wage categories based on the average wage for the occupation which may include workers with earnings both above and below the threshold.

The BLS data provide information on dependent care benefits that are available to workers. Data from the IRS based on W-2 information returns, however, suggest actual use of these benefits is relatively low. The most recent data available indicate about 1.5 million taxpayers received tax-free employer-sponsored dependent care benefits in 2017. In comparison, during the same year

---

34 Bureau of Labor Statistics, *National Compensation Survey: Employee Benefits in the United States*, March 2020, Tables 39 and 40. For purposes of this survey, employer-sponsored child care is defined as a workplace program that “provides for either the full or partial cost of caring for an employee’s children in a nursery, day care center, or a baby sitter in facilities either on or off the employer’s premises.”

35 Internal Revenue Service, *SOI Tax Stats - Individual Information Return Form W-2 Statistics*, Table 5A.
there were about 153 million returns filed, 6.5 million of which included the CDCTC. Results from one recent survey of low- and moderate-income taxpayers suggest that low employee participation in dependent care FSAs may be due to (1) employees’ confusion about the rules governing dependent care FSAs, (2) employees’ difficulties in determining whether they would benefit from participating in a dependent care FSA, and (3) employees confounding dependent care FSAs with similar plans such as health FSAs and health savings accounts (HSAs). In addition, a recent study on participation in health FSAs found evidence that employees may be particularly concerned about the risk of losing unused funds at the end of the plan year (the “use or lose” rule) when determining whether to participate in a FSA.


Appendix A. What Is a “Dependent” for Tax Purposes?

Prior to enactment of P.L. 115-97, taxpayers could subtract from their adjusted gross income (AGI) the standard deduction or sum of their itemized deductions (whichever is greater) and the appropriate number of personal exemptions for themselves, their spouse (if married), and their dependents.

For 2017, the personal exemption amount was $4,050 per person. Under P.L. 115-97, the personal exemption amount was reduced to zero from 2018 through the end of 2025. While the personal exemption is not in effect from 2018 through 2025, the definition of dependent for the exemption was retained and other provisions in the tax code still refer to this definition.

A dependent is either (1) a qualifying child or (2) a qualifying relative. There are several tests to determine whether an individual is a taxpayer’s qualifying child or relative, outlined in Table A-1. An individual must fulfill all these requirements to be considered a qualifying child or qualifying relative (e.g., an individual must fulfill the relationship, residence, age, support, and joint return test to be considered a qualifying child for tax purposes).

Table A-1. Tests for Qualifying Child and Qualifying Relative

<table>
<thead>
<tr>
<th>Qualifying Child</th>
<th>Qualifying Relative</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Relationship:</strong> The child is the taxpayer’s son, daughter, stepchild, foster child, brother, sister, half-brother, half-sister, stepbrother, stepsister, or a descendant of any of them.</td>
<td><strong>Member of Household or Relationship:</strong> The individual must be either (a) a member of the taxpayer’s household for the entire year, or (b) if they do not live with the taxpayer, a relative of the taxpayer.¹</td>
</tr>
<tr>
<td><strong>Residence:</strong> The child must have lived with the taxpayer for more than half the year.</td>
<td><strong>Gross Income Test:</strong> The individual’s gross income must be less than the personal exemption amount ($4,050 in 2017).</td>
</tr>
<tr>
<td><strong>Age:</strong> The child is either (a) under 19 years old at the end of the year; (b) under 24 years old at the end of the year and a full-time student; or (c) any age if permanently and totally disabled.</td>
<td><strong>Age:</strong> None</td>
</tr>
<tr>
<td><strong>Support:</strong> The child must not have provided more than half of his or her own support for the year.</td>
<td><strong>Support:</strong> The taxpayer must provide more than half of the qualifying individual’s support for the year.</td>
</tr>
<tr>
<td><strong>Joint Return:</strong> The child must not be filing a joint return for the year (unless that joint return is filed only to claim a refund of withheld income tax or estimated tax paid).</td>
<td><strong>Not a qualifying child:</strong> The individual cannot be claimed as a qualifying child by any taxpayer.</td>
</tr>
</tbody>
</table>

Source: IRS Publication 501 and Internal Revenue Code (IRC) §152.

a. The individual is related to the taxpayer as their son, daughter, stepchild, foster child, brother, sister, half-brother, half-sister, stepbrother, stepsister, or a descendant of any of them; father, mother, grandparent, or other direct ancestor; stepfather or stepmother; son or daughter of the taxpayer’s brother or sister; son or daughter of the taxpayer’s half-brother or half-sister; the taxpayer’s aunt or uncle; the taxpayer’s son-in-law, daughter-in-law, father-in-law, mother-in-law, brother-in-law, or sister-in-law.
Appendix B. Evaluating the Impact of the CDCTC After the Tax Cuts and Jobs Act (TCJA; P.L. 115-97)

IRS data indicate that the average dollar amount of the CDCTC has largely remained unchanged in recent years (see “Average Credit Amount over Time”). However, some low- and moderate-income taxpayers may find that the CDCTC provides less of a benefit now than it did prior to 2018 because of changes to the tax code made by P.L. 115-97, often referred to as the Tax Cuts and Jobs Act or TCJA.39

Although the law did not directly modify the CDCTC, other changes made by the law—specifically those made to a different credit, the child tax credit (CTC)—may effectively mean that some low- and moderate-income families owe the same amount of income taxes with or without the CDCTC. In other words, some of these families may no longer receive a net benefit from the CDCTC.40 However, other changes made by the law may result in the taxpayer receiving a larger overall benefit from the tax system (i.e., a large refund), even if the value of their CDCTC is lessened.

As Elaine Maag at the Tax Policy Center notes:41

Under prior law, families could receive their full $1,000 per child CTC as a refund. But when the CTC was increased to $2,000 (as other tax benefits were reduced) [as part of the TCJA], only part of the CTC increase was made refundable [$1,400]. Thus, families that would have received their full CTC as a refund last year now receive only part of their (increased) CTC as a refund. The rest of the CTC is used to offset income taxes owed, reducing the benefit possible from the CDCTC.

An example of the impact of the CDCTC on income tax liabilities before and after the TCJA may help to illustrate this issue. In both cases presented in Table B-1, it is assumed that a single parent has $28,000 of earned income, $6,000 in qualifying child care expenses, and two qualifying children. (Those children are also assumed to be eligible to be claimed for two other tax benefits often claimed by working families with children—the earned income tax credit, or EITC, and the CTC.) Further, the taxpayer is assumed to have no other income and claims the standard deduction. Calculations of precredit liability and the child tax credit differ between the two time periods because of various changes made to the individual income tax by the TCJA.42 The EITC

39 The original title of the law, the Tax Cuts and Jobs Act, was stricken before final passage because it violated what is known as the Byrd rule, a procedural rule that can be raised in the Senate when bills, like the tax bill, are considered under the process of reconciliation. The actual title of the law is “To provide for reconciliation pursuant to titles II and V of the concurrent resolution on the budget for fiscal year 2018.” For more information on the Byrd rule, see CRS Report RL30862, The Budget Reconciliation Process: The Senate’s “Byrd Rule”, by Bill Heniff Jr.

40 The analysis done by the Tax Policy Center analyzed how taxes would change with and without the CDCTC before and after P.L. 115-97 in order to determine the value of the CDCTC. According to the IRS, the CDCTC is applied to (and hence reduces) income tax liability before the nonrefundable portion of the child credit. However, only focusing on the dollar amount of the CDCTC, without examining how the presence of the CDCTC affects income tax liabilities, may provide an incomplete picture of the benefit’s impact in the broader context of the federal income tax code.


was generally unchanged by the law, although its value is annually adjusted for inflation, and that inflation adjustment was changed by the law.\footnote{For more information, see CRS Report R43805, *The Earned Income Tax Credit (EITC): How It Works and Who Receives It*, by Margot L. Crandall-Hollick, Gene Falk, and Conor F. Boyle.}

Table B-1. Impact of the CDCTC on Income Tax Liability After the TCJA

Single parent with two qualifying children, $28,000 of earned income, and $6,000 in qualifying child care expenses

<table>
<thead>
<tr>
<th></th>
<th>2018 (post-TCJA)</th>
<th>2017 (pre-TCJA)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>CDCTC</td>
<td>No CDCTC</td>
</tr>
<tr>
<td>Precredit Income Tax Liability(^a)</td>
<td>$1,000</td>
<td>$1,000</td>
</tr>
<tr>
<td>Child and Dependent Care Credit (CDCTC)</td>
<td>$1,000</td>
<td>$0</td>
</tr>
<tr>
<td>Child Tax Credit (CTC)(^b)</td>
<td>$2,800</td>
<td>$3,800</td>
</tr>
<tr>
<td>(CTC)—nonrefundable portion</td>
<td>$0</td>
<td>$1,000</td>
</tr>
<tr>
<td>(CTC)—refundable portion</td>
<td>$2,800</td>
<td>$2,800</td>
</tr>
<tr>
<td>Earned Income Tax Credit (EITC)(^c)</td>
<td>$3,749</td>
<td>$3,749</td>
</tr>
<tr>
<td>Final Tax Liability</td>
<td>-$6,549</td>
<td>-$6,549</td>
</tr>
<tr>
<td><strong>Net Impact of the CDCTC on Income Tax Liabilities</strong></td>
<td>(0)</td>
<td>(650)</td>
</tr>
</tbody>
</table>

**Source:** Calculations using NBER TAXSIM.

**Notes:** A negative income tax liability indicates a net benefit from the income tax code. The taxpayer is assumed to file as a head of household.

- a. The TCJA made numerous changes to the individual income tax system that may affect a taxpayer’s liability before tax credits. See CRS Report R45092, *The 2017 Tax Revision (P.L. 115-97): Comparison to 2017 Tax Law*, coordinated by Molly F. Sherlock and Donald J. Marples.
- c. The TCJA did not change major aspects of the EITC, although it did change how it was adjusted for inflation. See CRS Report R43805, *The Earned Income Tax Credit (EITC): How It Works and Who Receives It*, by Margot L. Crandall-Hollick, Gene Falk, and Conor F. Boyle.

As illustrated in Table B-1 above, in 2018 this taxpayer’s final income tax liability (a refund of $6,549) is unchanged by the CDCTC in 2018. (Per the IRS, the CDCTC is claimed before the nonrefundable portion of the child tax credit.) The $1,000 CDCTC effectively reduces the nonrefundable child tax credit by the same amount. The refundable portion of the child credit, capped at $2,800 for two children in this example, is unchanged. In contrast, before the TCJA changes, the CDCTC would have reduced the income tax liability for this taxpayer by $650 (increasing their refund from $4,932 to $5,582). In this case, since the taxpayer can receive all of the child credit as the refundable portion, the CDCTC does not reduce the total CTC. Instead, the CDCTC shifts receipt of the child tax credit from the nonrefundable portion to the refundable portion. Even though the CDCTC itself is larger in 2018 than 2017 ($1,000 vs. $650), in this example its impact on how much the taxpayer owes in taxes is reduced due to changes in the child tax credit.
According to analysis done by the Tax Policy Center on the impact of the CDCTC on income tax liabilities, between 2017 and 2018 the share of taxpayers with incomes between $20,000 and $30,000 who benefited from the child care credit decreased from 5% to 2%. In addition, “about 6 percent of families with incomes between $30,000 and $40,000 will benefit from the child care credit in 2018, down a third from the 9 percent who benefited in 2017.”

While the CDCTC credit value may have fallen for some low- and moderate-income families, the expansion of the child tax credit (and other changes made by P.L. 115-97) may offset some or all of these losses, as illustrated in Table B-1, leaving taxpayers with a larger net benefit (a refund of $6,549 vs. $5,582).

Author Information

Margot L. Crandall-Hollick
Acting Section Research Manager

Conor F. Boyle
Analyst in Social Policy

Disclaimer

This document was prepared by the Congressional Research Service (CRS). CRS serves as nonpartisan shared staff to congressional committees and Members of Congress. It operates solely at the behest of and under the direction of Congress. Information in a CRS Report should not be relied upon for purposes other than public understanding of information that has been provided by CRS to Members of Congress in connection with CRS’s institutional role. CRS Reports, as a work of the United States Government, are not subject to copyright protection in the United States. Any CRS Report may be reproduced and distributed in its entirety without permission from CRS. However, as a CRS Report may include copyrighted images or material from a third party, you may need to obtain the permission of the copyright holder if you wish to copy or otherwise use copyrighted material.