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Child Care and Development Fund
Annual Income Eligibility Levels
(Family of 3)
1997

State Name	Maximum Income Levels (85% of SMI)	Actual Eligibility Cutoff (if below 85% of SMI)	Low-income Priority Level
Alabama	$29,796	$14,484	$14,472
Alaska	$38,244	$38,244	$16,224
Arizona	$31,800	$18,000	$13,332
Arkansas	$26,068	$18,401	$12,267
California	$34,044	$30,036	$20,028
Colorado	$36,000	$24,648	$17,328
Connecticut	$44,376	$39,168	$13,056
District of Columbia	$25,068	$25,068	$11,988
Delaware	$30,492	$20,124	$4,056
Florida	NA	$12,984	NA
Georgia	$32,196	$24,276	$22,728
Hawaii	$39,084	$34,488	$15,336
Idaho	$25,056	$19,476	$13,332
Illinois	$37,092	$21,816	$13,092
Indiana	$33,708	$12,984	$13,332
Iowa	$33,780	$20,664	$16,668
Kansas	$46,608	$25,404	$20,592
Kentucky	$27,120	$17,724	$5,328
Louisiana	$29,580	$29,580	$13,320
Maine	$32,492	$32,492	$13,210
Maryland	$41,376	$22,440	$9,204
Massachusetts	$42,264	$33,252	$23,172
Michigan	$37,812	$26,064	$9,708
Minnesota	$38,844	$34,272	$10,992
Mississippi	$21,996	$21,996	$12,996
Missouri	$34,836	$17,784	$8,088
Montana	$28,008	$24,660	$5,256
Nebraska	$30,180	$23,292	$13,848
Nevada	$35,748	$31,536	$13,332
New Hampshire	$36,768	$21,408	$18,672
New Jersey	$43,846	$43,846	$33,325
New Mexico	$26,544	$23,412	$17,580
New York	$34,992	$26,964	*
North Carolina	$31,836	$28,092	$28,092
North Dakota	$29,340	$29,340	$3,456
Ohio	$33,444	$20,004	$8,400
Oklahoma	$27,696	$18,000	$18,000
Oregon	$33,012	$33,012	$12,756
Pennsylvania	$35,904	$31,320	$13,332
Rhode Island	$35,856	$24,660	$13,320
South Carolina	$31,104	$12,984	$12,984
South Dakota	$30,180	$20,004	$13,332
Tennessee	$30,084	$19,464	$15,024
Texas	$31,149	$27,484	$19,995
Utah	$32,040	$21,108	$12,984
Vermont	$27,696	$25,920	$13,332
Virginia	$35,724	$35,724	$13,332
Washington	$35,292	$23,328	$9,864
West Virginia	$21,240	$18,744	$9,996
Wisconsin	$34,968	$21,996	**
Wyoming	$35,832	$15,576	$14,280
Puerto Rico	$15,348	$15,348	$9,036

NA = Not available
*Low-income priority level set by counties
**Not applicable since WS will serve all children under the actual cutoff level

Data
In Dec
families } served
children

In Aug
income of
those served

Child Care and Development Fund
Sliding Fee Scales (Parent Co-Payments)
1997

DRAFT

State	Monthly Income Cutoff: Family of 3*	Fee Is Waived for (All, None, Some) Families At or Below Poverty?	Minimum Family Fee (full-time rate) **	Maximum Family Fee (full-time rate) **
Alabama	$1,858	Some	$5.00 (weekly)	$72.50 (weekly)
Alaska	$3,187	Some	3% of cost of care	75% of cost of care
Arizona	$1,500	Some	$0.50 (daily)	$3.00 (daily)
Arkansas	$1,533	All	$0	80% of cost of care
California	$2,149	All	$2.00 (daily)	$10.00 (daily)
Colorado	$2,000	Some	$5.00 (monthly)	$200.00 (monthly)
Connecticut	$3,263	Some	$0	$326.33 (monthly)
District of Columbia	$1,827	None	$7.00 per week	70% of fee plus $1.00 per child per week
Delaware	$1,677	All	1% of cost of care	46% of cost of care
Florida	$1,082	None	$0.80 (daily)	$9.60 (daily)
Georgia	$2,023	Some	$5.00 per week + $3.00 each additional child	$40.00 per week + $20.00 each additional child
Hawaii	$2,874	All	$0	20% of fee up to $280
Idaho	$1,623	Some	2% of cost of care	90% of the cost of care
Illinois	$1,818	None	$2.00 (weekly)	$57.00 (weekly)
Indiana	$2,056	All	$0	$10.00 (daily)
Iowa	$2,025	All	$0	$6.00 (half-day fee)
Kansas	$2,055	Some	$24.00 (monthly)	$223.00 (monthly)
Kentucky	$1,477	Some	$0	$8.75 (daily)
Louisiana	$2,465	All	$0	70% of cost of care
Maine	$2,708	Some	2% of gross income	10% of gross income
Maryland	$1,534	Some	$3.00	$209.00
Massachusetts	$2,771	Some	$1.00 (weekly)	$114.00 (weekly)
Michigan	$2,172	Some	5% of max. rate for care	70% of max. rate for care
Minnesota	$2,856	Some	$22.00 (monthly)	$491.00 (monthly)
Mississippi	$1,833	Some	$10.00	$158.00
Missouri	$1,482	Some	$1.00 per year	$4.00 (daily)
Montana	$2,055	Some	$5.00 (monthly)	$308.00 (monthly)
Nebraska	$1,333	All	$12.00 (monthly)	$132.00 (monthly)
Nevada	$2,517	Some	10% of cost of care	85% of cost of care
New Hampshire	$1,889	Some	$0	$0.50 per week per child plus 34% of daily cost of
New Jersey	$2,777	None	$9.10 (monthly)	$294.90 (monthly)
New Mexico	$1,951	Some	$0	$116.00 plus 19% of income over $1,150
New York	$2,247	Some	$184 (monthly)	$360.00 (monthly)
North Carolina	$2,341	Some	9% of cost of care	9% of cost of care
North Dakota	$2,445	Some	10% of cost of care	70% of cost of care
Ohio	$2,055	Some	$15	10% of family's adjusted monthly income
Oklahoma	$1,500	Some	$2.00 (monthly)	$201.00 (monthly)
Oregon	$2,088	Some	$25.00 (monthly)	$632.00 (monthly)
Pennsylvania	$2,610	Some	$5.00 (weekly)	$65.00 (weekly)
Rhode Island	$2,055	Some	$5.00 (weekly)	$23.00 (weekly)
South Carolina	$1,893	None	$3.00 (weekly)	$11.00 (weekly)
South Dakota	$2,055	All	5% of cost of care	85% of cost of care
Tennessee	$2,111	Some	$5.00 (weekly)	$32.00 (weekly)
Texas	$3,000	Some	$33.00 (monthly)	$330.00 (monthly)
Utah	$1,759	Some	$10.00 (monthly)	$255.00 (monthly)
Vermont	$2,160	All	$0	90% of cost of care
Virginia	$1,889	Some	12% of gross income	12% of gross income
Washington	$1,944	None	$10.00 (monthly)	$392.00 (monthly)
West Virginia	$1,562	Some	$.15 (daily)	$8.00 (daily)
Wisconsin	$2,348	None	$9.00 (weekly)	$91.00 (weekly)
Wyoming	$1,298	None	$0.05 per hour per child	$0.85 per hour per child
Puerto Rico	$1,279	All	$8.00 (monthly)	$45.00 (monthly)

* Where Lead Agency provided information on an annual income, income was divided by 12 and reported as "monthly."
** In some cases, Lead Agency has different co-payment scales based on type of provider used. In these cases, rates reported are for licensed, full-day centers.

DEPARTMENT OF HEALTH AND HUMAN SERVICES

ASSISTANT SECRETARY FOR PLANNING AND EVALUATION

PHONE: (202) 401-6127 FAX: (202) 690-6562

Date 10/9/97

From: *Jennifer Appleton*

Division: *ASPE*

Office Number: *(202) 401-6127*

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To: Cynthia Rice

Division:

Office Number: 456-2846

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Number of Pages + Cover 2

REMARKS Cynthia - Attached is an updated version of the table on child care numbers, which I distributed at the last Tax/subsidy meeting. The numbers have not changed, but some of the labels & footnotes have been refined.

DRAFT

FAMILIES WITH CHILDREN ELIGIBLE FOR CHILD CARE ASSISTANCE

Family Income by Poverty Level (cummulative)	**Non-Welfare Working Families w/ Children <13 years**[1] (families, in million)	**Welfare Familes w/ Children <13 years who are Required to Work Under PRWORA Work Requirements**[2] (families, in millions)	**Total Number of Families with Children Eligible for Child Care** (families, in millions)	**80% Utilization** (families, in millions)	**60% Utilization** (families, in millions)	**40% Utilization** (families, in millions)
Less than 100% of poverty	1.54	1.1	2.64	2.11	1.58	1.06
Less than 150% of poverty	3.23	1.1	4.33	3.46	2.60	1.73
Less than 185% of poverty	4.61	1.1	5.71	4.57	3.43	2.28
Less than 200% of poverty	5.19	1.1	6.29	5.03	3.77	2.52

1. Non-welfare working families are defined as single parent families in which the parent is working at least part time, or two-parent families in which both parents are working at least part time. Source: March 1996 CPS, with CY 1995 income data.

2. Under PRWORA, 25% of the approximately 4.38 million welfare families are required to go to work in 1997. Assuming a full 25% work participation rate, an additional 1.1 million families may be in need of child care. Historically welfare families have income levels of less than 100% of poverty.

DHHS/ASPE/HSP--October 8, 1997 (9:27am)

FAMILIES WITH CHILDREN POTENTIALLY IN NEED OF CHILD CARE

Family Income by Poverty Level (cummulative)	Non-Welfare Working Families w/ Children <13 years[1] (families, in million)	Welfare Familes w/ Children <13 years who are Required to Work Under PRWORA Work Requirements[2] (families, in millions)	Total Number of Families Potentially in Need of Child Care (families, in millions)	80% Utilization (families, in millions)	60% Utilization (families, in millions)	40% Utilization (families, in millions)
Less than 100% of poverty	1.54	1.1	2.64	2.11	1.58	1.06
Less than 150% of poverty	3.23	1.1	4.33	3.46	2.60	1.73
Less than 185% of poverty	4.61	1.1	5.71	4.57	3.43	2.28
59% = of SMI Less than 200% of poverty	5.19	1.1	6.29 → 9 M children	5.03	3.77 5-6 mi kids	2.52

1. Non-welfare working families are defined as single parent families in which the parent is working at least part time, or two-parent families in which both parents are working at least part time. Source: March 1996 CPS, with CY 1995 income data.

2. Under PRWORA, 25% of the approximately 4.38 million welfare families are required to go to work in 1997. Assuming a full 25% work participation rate, an additional 1.1 million families may be in need of child care. All welfare families have income levels of less than 100% of poverty.

September 29, 1997 (3:17pm)

Today $3B serves 1 M kids

→ Still need - # we think we cld serve if we added $X B

Effect of Options to Modify the Dependent Care Credit
Calendar-Year 1999 Effect; Assumes no Behavioral Response
(Number of returns in thousands; $ millions)

AGI		Returns with One or More Children Under Six			All Returns		
From:	To:	Number of Returns With Tax Change	Total Tax Change	Average per Return	Number of Returns With Tax Change	Total Tax Change	Average per Return
		Option 1: Increase Phaseouts and Index Credit \1					
<0	20,000	43	(2)	(47)	110	(4)	(36)
20,000	30,000	452	(46)	(102)	726	(71)	(98)
30,000	40,000	522	(42)	(80)	841	(66)	(78)
40,000	50,000	206	(7)	(34)	375	(11)	(29)
50,000	75,000	0	0		0	0	
75,000	*****	0	0		0	0	
Total		1,223	(97)	(79)	2,052	(152)	(74)
		Option 2: Increase Credit Rate to 50 Percent, plus Option 1. \2					
<0	20,000	43	(5)	(116)	110	(15)	(136)
20,000	30,000	452	(141)	(312)	726	(225)	(310)
30,000	40,000	522	(134)	(257)	841	(212)	(252)
40,000	50,000	329	(26)	(79)	543	(42)	(77)
50,000	75,000	0	0		0	0	
75,000	*****	0	0		0	0	
Total		1,346	(306)	(227)	2,220	(494)	(223)
		Option 3: Increase Expense Limit for Children under 6, plus Option 1. \3					
<0	20,000	43	(2)	(47)	110	(4)	(36)
20,000	30,000	452	(92)	(204)	726	(116)	(160)
30,000	40,000	522	(96)	(184)	841	(119)	(141)
40,000	50,000	280	(39)	(139)	449	(44)	(98)
50,000	75,000	438	(96)	(219)	438	(95)	(217)
75,000	*****	503	(137)	(272)	500	(140)	(280)
Total		2,238	(462)	(206)	3,064	(518)	(169)

Department of the Treasury 30-Sep-97

1/ Under option 1, starting in 1999, the credit rate would begin to phase-down from 30% to 20% between $18,000 and $45,000 (compared to $10,000 and $28,000 under current law). In the year 2000, the starting point of the phase-out range is indexed for inflation, as is the amount of qualifying expenses and the maximum amount that employers can exclude for dependent care benefits (this is $5000 under current law).

2/ Option 2 modifies option 1 to increase the initial credit rate to 50% of qualifying expenses; the phase-down from 50% to 20% is from $18,000 to $47,000.

3/ Option 3 modifies option 1 to allow a maximum of $4,200 in qualifying expenses for children under 6, starting in 1999 and indexed thereafter. The family maximum is modified accordingly ($8,400 with two children under 6; $6,600 with one child under 6 and one child 6 and over; $4,800 with two children 6 and over).

Effects of Options to Modify Child and Dependent Care Tax Credit on Hypothetical Taxpayers

Option 1: In 1999, child and dependent care tax credit rate would be increased to 30 percent for taxpayers with adjusted gross income (AGI) below $18,000. The credit rate would be reduced by one percentage point for each additional $3,000 of AGI. The credit rate would be 20 percent for taxpayers with AGI above $45,000.

Option 2: In 1999, child and dependent care tax credit rate would be increased to 50 percent for taxpayers with AGI below $18,000. The credit rate would be reduced by one percentage point for each additional $1,000 of AGI. The credit rate would be 20 percent for taxpayers with AGI above $47,000.

Option 3: Same as Option 1, but maximum qualifying expenses would be increased to $4,200 if taxpayer had one child under the age of six, $6,600 if the taxpayer has two children and one is under the age of six, and $8,400 if taxpayer has two children and both are under the age of six.

- Taxpayers will not benefit from either an increase in the credit rate or the maximum allowable expenses if they currently do not have a positive income tax liability.

  -- A single taxpayer with one child, and income of $15,000, has a pre-credit income tax liability of $450. Under current law, she is eligible for a $500 child credit. If her child care expenses are $1,900, she would also be eligible for a child and dependent care tax credit of $513. In combination, the current law credits are more than enough to offset her tax liability. She will not benefit from options that increase the child and dependent care tax credit rate or the maximum amount of allowable expenses.

  -- A married couple with two children, income of $25,000, and child care expenses of $3,750 would also not benefit from an increase in the credit rate or the maximum allowable expenses. Their pre-credit income tax liability of $975 is completely offset by the current law child and dependent care tax credit ($825) and the child credit ($1,000). Modifications in the child and dependent care tax credit rate or the maximum amount of allowable expenses will not benefit the couple.

- For many moderate income taxpayers, options to increase the credit rate will generally be more beneficial than options to increase the maximum amount of expenses.

  -- A married couple with two children, ages 5 and 10, and income of $35,000, spends about $4,050 on child care during 1999. Under current law, their net income tax liability is $665. Under option 1, the child and dependent care tax credit rate will increase from 20 percent to 24 percent. As a consequence, their tax liability will decline by $162 to $503. Under option 2, the credit rate will increase to 33 percent, causing their tax liability to fall by $527 to $139. Under option 3, they can apply a 24 percent credit rate to a higher expense limitation, but do not benefit because their child care costs are less than the current limitation. Their income tax liability will decline by the same amount as under option 1 ($162 to $503).

- Taxpayers with large child care expenses may benefit from either an increase in the maximum amount of expenses or the credit rate.

  -- A single parent with one child and $35,000 of income will receive the same benefits under options 1 and 2, regardless of whether she spends $2,700 or $5,400 on child care. With child care expenses of $2,700, she would benefit more from a significant increase in the credit rate (as under option 2) than from an increase in the maximum amount of expenses and a smaller increase in the credit rate (as under option 3). Thus, an increase in the credit rate from 20 percent to 33 percent (option 2) will result in a tax cut of $312, while an increase in the expense limit to $4,200 and a credit rate of 24 percent (option 3) will cause her taxes to fall by $168. If, on the other hand, her expenses were $5,400, option 2 would still only result in a tax reduction of $312, while option 3 would reduce her taxes by $528.

- Under option 3, the increase in the qualifying expenses is applicable to all taxpayers. Thus, a taxpayer with income over $50,000 could benefit from an increase in the maximum amount of allowable expenses.

  -- A single parent with $55,000 of income and one child would benefit from option 3, if her expenses exceeded $2,400.

Effects of Modifications to Child and Dependent Care Tax Credit
Single Head of Household, One Child Under 6, $15,000 of Income, and $1,900 of Child Care Expenses
1999 Dollars

	Current Law	Modifications to Current Law Option 1	Option 2	Option 3
Earnings	15,000	15,000	15,000	15,000
Other Forms of Income	0	0	0	0
Child Care Expenses	1,900	1,900	1,900	1,900
Adjusted Gross Income	15,000	15,000	15,000	15,000
-- Standard Deduction	-6,400	-6,400	-6,400	-6,400
-- Exemptions	-5,600	-5,600	-5,600	-5,600
Taxable Income	3,000	3,000	3,000	3,000
Pre-Credit Income Tax Liability	450	450	450	450
-- Child and Dependent Care Credit	-513	-570	-950	-570
-- $500 Child Credit	-500	-500	-500	-500
-- Earned Income Tax Credit	-1,951	-1,951	-1,951	-1,951
Post-Credit Income Tax Liability	-1,951	-1,951	-1,951	-1,951
Change in Tax Liability From Current Law		0	0	0

Department of the Treasury
Office of Tax Analysis

September 29, 1997

Option 1: Child and dependent care tax credit rate would be 30% for taxpayers with AGI below $18,000. Credit rate would be reduced by 1 percentage point for each additional $3,000 of AGI. Credit rate would be 20% for AGI above $45,000.

Option 2: Child and dependent care tax credit rate would be 50% for taxpayers with AGI below $18,000. Credit rate would be reduced by 1 percentage point for each additional $1,000 of AGI. Credit rate would be 20% for AGI above $47,000.

Option 3: Same as Option 1, but maximum qualifying expenses would increase to $4,200 if taxpayer has one child only and the child is under six, $6,600 if the taxpayer has two children and one child is under six, and $8,400 if taxpayer has two children and both are under six.

Effects of Modifications to Child and Dependent Care Tax Credit
Married Couple, Two Children (Ages 5 and 10), $25,000 of Income, and $3,750 of Child Care Expenses
1999 Dollars

		Modifications to Current Law		
	Current Law	Option 1	Option 2	Option 3
Combined Earnings (Both Employed) 1/	25,000	25,000	25,000	25,000
Other Forms of Income	0	0	0	0
Child Care Expenses	3,750	3,750	3,750	3,750
Adjusted Gross Income	25,000	25,000	25,000	25,000
-- Standard Deduction	-7,300	-7,300	-7,300	-7,300
-- Exemptions	-11,200	-11,200	-11,200	-11,200
Taxable Income	6,500	6,500	6,500	6,500
Pre-Credit Income Tax Liability	975	975	975	975
-- Child and Dependent Care Credit	-825	-1,013	-1,613	-1,013
-- $500 Child Credit	-1,000	-1,000	-1,000	-1,000
-- Earned Income Tax Credit	-1,246	-1,246	-1,246	-1,246
Post-Credit Income Tax Liability	-1,246	-1,246	-1,246	-1,246
Change in Tax Liability From Current Law		0	0	0

Department of the Treasury
Office of Tax Analysis

September 29, 1997

1/ Earnings of lower earner are greater than child care expenses.

Option 1: Child and dependent care tax credit rate would be 30% for taxpayers with AGI below $18,000. Credit rate would be reduced by 1 percentage point for each additional $3,000 of AGI. Credit rate would be 20% for AGI above $45,000.

Option 2: Child and dependent care tax credit rate would be 50% for taxpayers with AGI below $18,000. Credit rate would be reduced by 1 percentage point for each additional $1,000 of AGI. Credit rate would be 20% for AGI above $47,000.

Option 3: Same as Option 1, but maximum qualifying expenses would increase to $4,200 if taxpayer has one child only and the child is under six, $6,600 if the taxpayer has two children and one child is under six, and $8,400 if taxpayer has two children and both are under six.

Effects of Modifications to Child and Dependent Care Tax Credit
Married Couple, Two Children (Ages 5 and 10), $35,000 of Income, and $4,050 of Child Care Expenses
1999 Dollars

	Current Law	Modifications to Current Law Option 1	Option 2	Option 3
Combined Earnings (Both Employed) 1/	35,000	35,000	35,000	35,000
Other Forms of Income	0	0	0	0
Child Care Expenses	4,050	4,050	4,050	4,050
Adjusted Gross Income	35,000	35,000	35,000	35,000
-- Standard Deduction	-7,300	-7,300	-7,300	-7,300
-- Exemptions	-11,200	-11,200	-11,200	-11,200
Taxable Income	16,500	16,500	16,500	16,500
Pre-Credit Income Tax Liability	2,475	2,475	2,475	2,475
-- Child and Dependent Care Credit	-810	-972	-1,337	-972
-- $500 Child Credit	-1,000	-1,000	-1,000	-1,000
-- Earned Income Tax Credit	0	0	0	0
Post-Credit Income Tax Liability	665	503	139	503
Change in Tax Liability From Current Law		-162	-527	-162

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Office of Tax Analysis

September 29, 1997

1/ Earnings of lower earner are greater than child care expenses.

Option 1: Child and dependent care tax credit rate would be 30% for taxpayers with AGI below $18,000. Credit rate would be reduced by 1 percentage point for each additional $3,000 of AGI. Credit rate would be 20% for AGI above $45,000.

Option 2: Child and dependent care tax credit rate would be 50% for taxpayers with AGI below $18,000. Credit rate would be reduced by 1 percentage point for each additional $1,000 of AGI. Credit rate would be 20% for AGI above $47,000.

Option 3: Same as Option 1, but maximum qualifying expenses would increase to $4,200 if taxpayer has one child only and the child is under six, $6,600 if the taxpayer has two children and one child is under six, and $8,400 if taxpayer has two children and both are under six.

Effects of Modifications to Child and Dependent Care Tax Credit
Single Head of Household, One Child Under 6, $35,000 of Income, and $2,700 of Child Care Expenses
1999 Dollars

	Current Law	Modifications to Current Law		
		Option 1	Option 2	Option 3
Earnings	35,000	35,000	35,000	35,000
Other Forms of Income	0	0	0	0
Child Care Expenses	2,700	2,700	2,700	2,700
Adjusted Gross Income	35,000	35,000	35,000	35,000
-- Standard Deduction	-6,400	-6,400	-6,400	-6,400
-- Exemptions	-5,600	-5,600	-5,600	-5,600
Taxable Income	23,000	23,000	23,000	23,000
Pre-Credit Income Tax Liability	3,450	3,450	3,450	3,450
-- Child and Dependent Care Credit	-480	-576	-792	-648
-- $500 Child Credit	-500	-500	-500	-500
-- Earned Income Tax Credit	0	0	0	0
Post-Credit Income Tax Liability	2,470	2,374	2,158	2,302
Change in Tax Liability From Current Law		-96	-312	-168

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Office of Tax Analysis

September 29, 1997

Option 1: Child and dependent care tax credit rate would be 30% for taxpayers with AGI below $18,000. Credit rate would be reduced by 1 percentage point for each additional $3,000 of AGI. Credit rate would be 20% for AGI above $45,000.

Option 2: Child and dependent care tax credit rate would be 50% for taxpayers with AGI below $18,000. Credit rate would be reduced by 1 percentage point for each additional $1,000 of AGI. Credit rate would be 20% for AGI above $47,000.

Option 3: Same as Option 1, but maximum qualifying expenses would increase to $4,200 if taxpayer has one child only and the child is under six, $6,600 if the taxpayer has two children and one child is under six, and $8,400 if taxpayer has two children and both are under six.

Effects of Modifications to Child and Dependent Care Tax Credit
Single Head of Household, One Child Under 6, $35,000 of Income, and $5,400 of Child Care Benefits
1999 Dollars

	Current Law	Modifications to Current Law		
		Option 1	Option 2	Option 3
Earnings	35,000	35,000	35,000	35,000
Other Forms of Income	0	0	0	0
Child Care Expenses	5,400	5,400	5,400	5,400
Adjusted Gross Income	35,000	35,000	35,000	35,000
-- Standard Deduction	-6,400	-6,400	-6,400	-6,400
-- Exemptions	-5,600	-5,600	-5,600	-5,600
Taxable Income	23,000	23,000	23,000	23,000
Pre-Credit Income Tax Liability	3,450	3,450	3,450	3,450
-- Child and Dependent Care Credit	-480	-576	-792	-1,008
-- $500 Child Credit	-500	-500	-500	-500
-- Earned Income Tax Credit	0	0	0	0
Post-Credit Income Tax Liability	2,470	2,374	2,158	1,942
Change in Tax Liability From Current Law		-96	-312	-528

Department of the Treasury
Office of Tax Analysis

September 29, 1997

Option 1: Child and dependent care tax credit rate would be 30% for taxpayers with AGI below $18,000. Credit rate would be reduced by 1 percentage point for each additional $3,000 of AGI. Credit rate would be 20% for AGI above $45,000.

Option 2: Child and dependent care tax credit rate would be 50% for taxpayers with AGI below $18,000. Credit rate would be reduced by 1 percentage point for each additional $1,000 of AGI. Credit rate would be 20% for AGI above $47,000.

Option 3: Same as Option 1, but maximum qualifying expenses would increase to $4,200 if taxpayer has one child only and the child is under six, $6,600 if the taxpayer has two children and one child is under six, and $8,400 if taxpayer has two children and both are under six.

Effects of Modifications to Child and Dependent Care Tax Credit
Single Head of Household, One Child Under 6, $55,000 of Income, and $2,700 of Child Care Expenses
1999 Dollars

	Current Law	Modifications to Current Law: Option 1	Option 2	Option 3
Earnings	55,000	55,000	55,000	55,000
Other Forms of Income	0	0	0	0
Child Care Expenses	2,700	2,700	2,700	2,700
Adjusted Gross Income	55,000	55,000	55,000	55,000
-- Standard Deduction	-6,400	-6,400	-6,400	-6,400
-- Exemptions	-5,600	-5,600	-5,600	-5,600
Taxable Income	43,000	43,000	43,000	43,000
Pre-Credit Income Tax Liability	7,503	7,503	7,503	7,503
-- Child and Dependent Care Credit	-480	-480	-480	-540
-- $500 Child Credit	-500	-500	-500	-500
-- Earned Income Tax Credit	0	0	0	0
Post-Credit Income Tax Liability	6,523	6,523	6,523	6,463
Change in Tax Liability From Current Law		0	0	-60

Department of the Treasury
Office of Tax Analysis

September 29, 1997

Option 1: Child and dependent care tax credit rate would be 30% for taxpayers with AGI below $18,000. Credit rate would be reduced by 1 percentage point for each additional $3,000 of AGI. Credit rate would be 20% for AGI above $45,000.

Option 2: Child and dependent care tax credit rate would be 50% for taxpayers with AGI below $18,000. Credit rate would be reduced by 1 percentage point for each additional $1,000 of AGI. Credit rate would be 20% for AGI above $47,000.

Option 3: Same as Option 1, but maximum qualifying expenses would increase to $4,200 if taxpayer has one child only and the child is under six, $6,600 if the taxpayer has two children and one child is under six, and $8,400 if taxpayer has two children and both are under six.

9/24
Child Care
Subsidy

Current federal law allows
_ up to 85% of SMI | Average @ 50% SMI

Low income families pay 21% of income on child care
(SIPP - Don Oellerich - 1995)

Tables from HHS + Treasury show
that families bet 100 - 200% of poverty
not served by either tax credit or subsidy

Tax credit doesn't help those under 200% poverty

Even if refundable [which they still oppose]
- many wouldn't file
- only 20% of cost paid for

Other concern = Treasury concerned about putting
tax credits on table - given Congress'n
→ won't be able to control pres

Joan - Urban Institute doing analysis of ~~[illegible]~~ need
modification

Qs

Subsidy
- where will states spend more $ if they had it
- What % of need do states serve

Taxes
- How many more families will get higher tax credit
- What are examples of families?

Preliminary Rough Draft

September 23, 1997

MEMORANDUM FOR DISTRIBUTION

SUBJECT: Child Care Subsidies

Much of our work over the last few weeks has been to get a better sense of the seemingly simple question: who benefits from existing public subsidies for child care. The work has had mixed success. It is strikingly difficult to calculate the number of families "eligible" for existing subsidies (put loosely, this typically requires that all parents are in the paid labor market and pay for child care from a tax-compliant provider). Problems are exacerbated by disparate data sources providing information on the primary sources of assistance: direct expenditures, the child and dependent care tax credit (CDCTC) and the employer exclusion for child care.

What income groups benefit from child care subsidies?

- o In one sense this is an easy question. Direct expenditures appear to be well targeted. Most benefits go to families at or below the poverty level and almost all benefits go to families go to families with incomes less than 200 percent of poverty.

- o Because low-income families pay little (or no) individual income taxes, tax benefits through the CDCTC and the employer exclusion go to higher-income families.

  - The August 27 table provides specific information. The table shows the income thresholds at which families become taxable, both before (the top panel of the table) and after (the bottom panel of the table) TRA97.

    -- The column labeled "Category 1" shows that no families with incomes below the poverty line will benefit from the CDCTC.

    -- Increasing the CDCTC will primarily benefit families in "Category 3." Hence, increases in the CDCTC will accrue mostly to families with incomes exceeding 170 percent of poverty.

  - It is clear, simply from the structure of the CDCTC, that its ability to assist low- and moderate-income families is limited.

- o This assessment is confirmed by the September 23 table showing the distribution of the CDCTC by family money income deciles.

  - The first column shows the number of families where all parents earned at least $1,000 per year, have children under 13 and receive the CDCTC. In aggregate, 5.8

million families receive the CDCTC. The average credit is $443 resulting from an average of $2,346 of qualified expenses.

- The second column is an attempt to calculate a number we would be very interested in seeing: namely, the percentage of people with child care expenses who receive the CDCTC. We are unable to calculate accurately the denominator of this percentage – the number of families with children under 13 where all parents work and who have paid child care expenses. To the extent biases in the proxy for this measure are constant across income deciles, the figures suggest the participation rate may be fairly uniform across income deciles.

- The sixth column shows the fraction of total child care expenditures subsidized by the CDCTC is fairly uniform, and varies between 13 and 18 percent across income deciles.

  -- The average CDCTC ($443) is much smaller than the average expenditure subsidy which, in the preliminary HHS calculations, varies from $58 to $66 <u>per week</u>.

o One might be puzzled by the fact that "average total child care expenditures" (column 7) do not increase sharply with income. The explanation is (probably) given by the September 23 table showing the distribution of employer provided dependent care benefit.

- This table shows that more than 80 percent of the benefit of the employer exclusion for child care expenses accrues to the top two deciles of the income distribution. Families in the top income decile are nearly twice as likely to have their child care expenditures subsidized by the employer exclusion than the CDCTC.

Update on tax provisions to subsidize child care

o Concerns have been expressed about proposing tax initiatives in the FY98 Budget.

o With two caveats: it is not clear that we will support any tax incentives, and any tax incentives that are proposed will not benefit poor families and will have relatively modest benefits for near-poor families, we have made preliminary, rough calculations of the annual cost of several changes to the CDCTC. Would be indexed for inflation in future

More generous subsidy for those now eligible; doesn't increase # people eligible

- Move the phaseout range of the CDCTC credit to $18,000 to $47,000. $250-$350 mil in year 2003
  phaseout pt every $3000

- Use the same phaseout range for the credit as above, but raise the top credit to 50 percent (and phaseout to 20 percent). $500-550 mil in year 2003

- Move the phaseout range of the CDCTC credit to $18,000 to $47,000, and raise the qualifying expenses covered by the CDCTC to $4,200 for children under 6. would particularly help higher income

1982 # indexed for inflation

Q: how many more families will get benefit? Q: what are example families?

Beneficiaries of Different Types of Modifications to the Child and Dependent Care Tax Credit
1999 Dollars

Type of Taxpayer	Poverty Threshold	Pre-Credits Income Tax Threshold	Category 1: Income Tax Liability = $0 With $500 Child Credit	Category 2: Income Tax Liability < Maximum Child and Dependent Care Credit	Category 3: Income Tax Liability > Maximum Child and Dependent Care Credit
pre-BBA Not Eligible for $500 Child Credit					
Head of Household; 1 Child	11,435	12,000	AGI below $12,000	AGI between $12,000 and $16,160	AGI above $16,160
Head of Household; 2 Children	13,552	14,800	AGI below $14,800	AGI between $14,800 and $22,160	AGI above $22,160
Head of Household; 3 Children	17,354	17,600	AGI below $17,600	AGI between $17,600 and $24,640	AGI above $24,640
Married, filing Joint; 1 Child	13,552	15,700	AGI below $15,700	AGI between $15,700 and $19,700	AGI above $19,700
Married, filing Joint; 2 Children	17,354	18,500	AGI below $18,500	AGI between $18,500 and $25,540	AGI above $25,540
Married, filing Joint; 3 Children	20,518	21,300	AGI below $21,300	AGI between $21,300 and $28,000	AGI above $28,000
after BBA Eligible for $500 Child Credit					
Head of Household; 1 Child	11,435	12,000	AGI below $15,333	AGI between $15,333 and $19,333	AGI above $19,333
Head of Household; 2 Children	13,552	14,800	AGI below $21,467	AGI between $21,467 and $28,000	AGI above $28,000
Head of Household; 3 Children	17,354	17,600	AGI below $27,600	AGI between $27,600 and $34,000	AGI above $34,000
Married, filing Joint; 1 Child	13,552	15,700	AGI below $19,033	AGI between $19,033 and $22,713	AGI above $22,713
Married, filing Joint; 2 Children	17,354	18,500	AGI below $25,167	AGI between $25,167 and $31,567	AGI above $31,567
Married, filing Joint; 3 Children	20,518	21,300	AGI below $31,300	AGI between $31,300 and $37,700	AGI above $37,700

Department of the Treasury
Office of Tax Analysis

Credit doesn't help families

Increasing credit won't help families

August 27, 1997

Increasing credit will help these families

Notes:
Category 1: Taxpayers would benefit from expansion of child and dependent care tax credit only if credit was made refundable.
Category 2: Taxpayers would benefit from an increase in the credit rate if tax liability is greater than the product of expenses and current credit rate.
Category 3: Taxpayers would benefit from an increase in the credit rate and possibly an increase in the maximum amount of allowable expenses.

Taxpayers (both spouses, if married) are assumed to be workers, to have earnings in excess of qualifying expenses, and to use the standard deduction.
FY 1998 winter budget assumptions used to project income levels.

Current credit rate structure:

AGI less than or equal to $10,000	30%	AGI less than or equal to $22,000	24%
AGI less than or equal to $12,000	29%	AGI less than or equal to $24,000	23%
AGI less than or equal to $14,000	28%	AGI less than or equal to $26,000	22%
AGI less than or equal to $16,000	27%	AGI less than or equal to $28,000	21%
AGI less than or equal to $18,000	26%	AGI greater than $28,000	20%
AGI less than or equal to $20,000	25%		

PRELIMINARY

Distribution of Child and Dependent Care Tax Credit by Family Money Income (Plus Food Stamps)

1998

not per child
per family

Family Money Income Deciles	Number of Eligible* Families with Child <13 & Credit (000)	Percent of Eligible Families with Child <13 (%)	Total Expenses ($ Mil.)	Qualifying Expenses ($ Mil.)	Credit Amount ($ Mil.)	* Credit as Percent of Total Exp. (%)	Average Total Exp. ($)	Average Qual. Exp. ($)	* Average Credit ($)
First	*	*	*	*	*	*	n.a.	n.a.	n.a.
Second	110	5	203	185	34	17	1,843	1,683	305
Third	413	15	920	807	162	18	2,229	1,955	394
Fourth	585	22	1,473	1,297	263	18	2,516	2,216	449
Fifth	681	30	1,896	1,631	308	16	2,784	2,395	452
Sixth	628	29	1,711	1,382	260	15	2,723	2,199	414
Seventh	794	30	2,090	1,827	341	16	2,630	2,300	429
Eighth	856	30	2,316	2,003	377	16	2,705	2,340	441
Ninth	1,010	32	2,976	2,504	466	16	2,947	2,479	462
Tenth	718	28	2,653	1,960	357	13 **	3,693	2,728	497
Total	5,796	24	16,237	13,597	2,568	16	2,801	2,346	443 per year

doesn't rise w/ income much

Department of the Treasury
Office of Tax Analysis

September 23, 1997
v. 12adj

Subsidies about $60/wk x 52

Notes:
The end points of the income deciles are: first, $9,570; second, $15,470; third, $21,150; fourth, $27,323; fifth, $34,091; sixth, $42,197; seventh, $52,570; eighth, $67,714; ninth, $93,039. Taxpayers with negative income are not shown in the decile classes but are included in total. Deciles derived from income distribution for all families.

*To be eligible for the child and dependent care tax credit, a taxpayer must be employed or looking for work. If married, both spouses must generally be employed; however, an employed taxpayer with a spouse who is either disabled or a full-time student may qualify. In tabulations, taxpayer is assumed to be eligible if employed and earning over $1,000 per annum. If married, both spouses met this test. Taxpayers must also incur expenses for child care to receive the credit; this criteria is not taken into account in measure of "eligible families" above.

more per year

Total expenses as would be reported on line 2 of the form 2441. This would include all expenses for child and dependent care reported paid to a provider in 1998. Expenses incurred in another year, but paid in 1998, would be included in this total.

Constrained expenses as would be reported on line 4 of the form 2441. This would include expenses for child and dependent care, up to the statutory maximums ($2,400 for one child, $4,800 for two or more children) both incurred and paid in 1998.

Credit amount to extent that it offset income tax liability (before other personal credits).

** High income families may have incentive to under-report (only get credit for certain amount; supposed to match "pay" of nanny)

PRELIMINARY

Distribution of Child and Dependent Care Tax Credit by Family Money Income (Plus Food Stamps)

1998

Family Money Income Deciles	Child and Dependent Care Tax Credit			
	Number of Families (%)	Total Expenses (%)	Qualifying Expenses (%)	Credit Amount (%)
First	0	0	0	0
Second	2	1	1	1
Third	7	6	6	6
Fourth	10	9	10	10
Fifth	12	12	12	12
Sixth	11	11	10	10
Seventh	14	13	13	13
Eighth	15	14	15	15
Ninth	17	18	18	18
Tenth	12	16	14	14
Total	100	100	100	100

Department of the Treasury
Office of Tax Analysis

September 23, 1997
v. 12adj.

Notes:
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Credit amount to extent that it offset income tax liability (before other personal credits).

PRELIMINARY
Distribution of Employer Provided
Dependent Care Benefits
1995

"D-Cap" "Section 129"

Adjusted Gross Income Decile	Total Benefits W-2 (%)	Capped Benefits W-2 (%)
First	0	0
Second	0	0
Third	0	0
Fourth	0	0
Fifth	1	1
Sixth	2	2
Seventh	3	3
Eighth	10	11
Ninth	24	24
Tenth	60	59
Total	100	100

Department of the Treasury 9/23/97
Office of Tax Analysis

DRAFT

Families Receiving Child Care by Income Level

	At or Below Poverty	Between Poverty and 150% of Poverty	Between 150% and 200% of Poverty	Above 200% of Poverty	Total Families
CCDBG (N=50)	234.2	90.6	50.2	4.9	379.8
Transitional Child Care (N=50)	50.9	19.7	10.9	1.1	82.5
At-Risk Child Care (N=41)	82.9	32.1	17.8	1.7	134.5
AFDC/JOBS Child Care (N=46)	143.7	-	-	-	143.7

(Thousands)

Notes:
1. The 50 States, District of Columbia, and Puerto Rico are included in this report.
2. CCDBG families are reported on an annual aggregate (unduplicated) basis (ACF-700).
3. Transitional, At-Risk, and AFDC/JOBS families are reported on an average monthly basis.
4. Transitional and At-Risk families are not reported by income levels; CCDBG percentages were applied to these two groups since they are more likely to participate in a similar manner.
5. AFDC/JOBS families are not reported by income levels. We have assumed all these families are below poverty since they are more likely to work part time.

Average Child Care Subsidy Payments

1995

	CCDBG (N=50)	TCC (N=51)	At-Risk	AFDC/JOBS (N=44)
Average Subsidy for Full-Time Care per Week per Child**	$ 66	$ 58	*	$ 58

* Data not available

**CCDBG average weekly care calculated by multiplying the average hourly rate ($1.64) reported on the ACF-700 by 40 hours. Average TCC and AFDC/JOBS weekly care calculated by dividing the average paid for full-time care (31-50 hours) by 4.3 (average number of weeks per month).

Ratio of Children to Families, 1995

	CCDBG (N=50)	TCC (N=49)	At-Risk (N=41)	AFDC (N=45)
Ratio of Children to Families	1.78	1.69	1.48	1.85

Cynthia -
CEA childcare
memo, as
discussed.
Nicole

cc Jen + Nicole
Child care file

9-8-97

'97 SEP 5 AM9:03

WEEKLY ECONOMIC BRIEFING OF THE PRESIDENT OF THE UNITED STATES

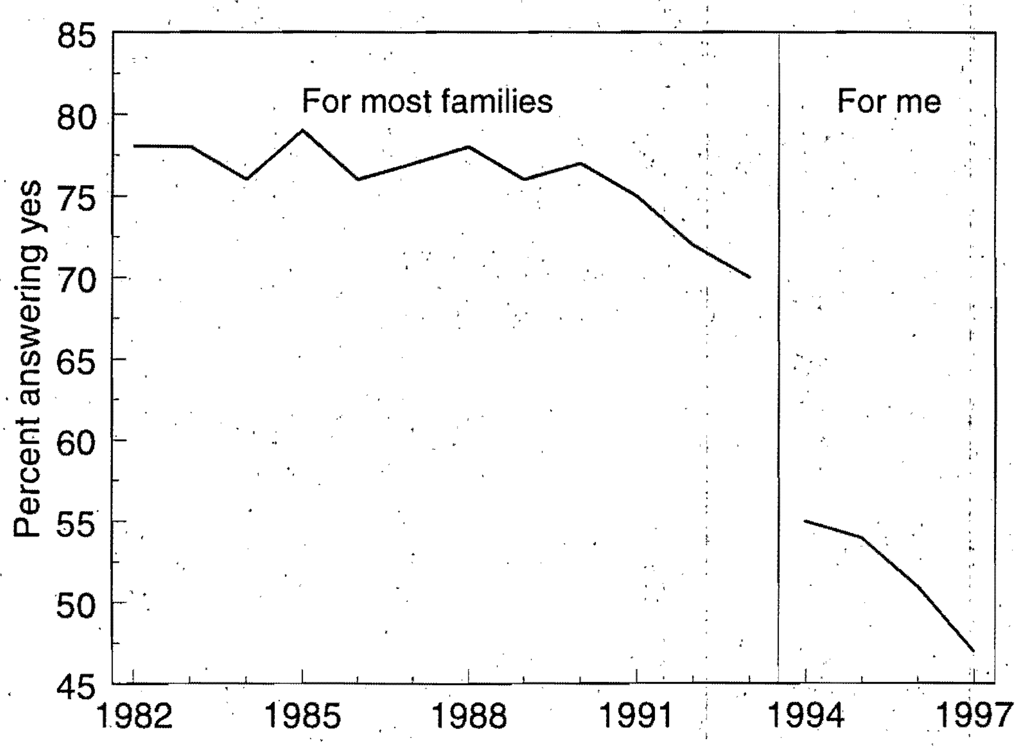
Prepared by the Council of Economic Advisers
with the assistance of the Office of the Vice President

September 5, 1997

copied
to:
COS
HRC pages 4-
Yellen

CHART OF THE WEEK

Survey Question: Is the Stock Market Too Risky?



During the 1990s, and especially in the past few years, a declining proportion of Americans has thought the stock market is too risky a place to put its money. More than three-quarters of the married men surveyed thought the stock market was too risky for most families through most of the 1980s, but that proportion fell to 70 percent by 1993. The survey question was changed in 1994, but the number of married men responding that the stock market is too risky for them has continued to fall. Responses for women show a similar pattern.

9-8-97

cc: HRC

SPECIAL ANALYSIS

Welfare Reform and the Market for Child Care

As more mothers move off welfare into work, the demand for child care services will increase. Although the supply of child care services is likely to expand to meet this demand without much of a price increase, the cost of child care, even at current prices, represents a large burden for low-income families.

The supply response. Two strands of evidence suggest that increased demand can be met without a substantial increase in the price of child care. First, over the past 20 years, the number of children in paid child care has approximately doubled while the real price of care has not changed. Second, a recent study indicates that changes in the price of child care induce large supply responses. Of course, an initial surge in demand could produce some short-run upward pressure on prices. The cost of entering the child care provider market is relatively low, however, and supply should respond relatively quickly.

The burden of current prices. The current cost of child care can be a significant burden for those without access to subsidized care and may discourage some mothers from working. Among families who pay for child care, poor families with employed mothers spend about 20 percent of their income on child care, while non-poor families spend only 7 percent. Estimates from several studies suggest that a 10 percent reduction in the price of child care increases the probability that a mother will work by 2 to 8 percent. Given that the mother has a job, however, the price of child care does not appear to influence the number of hours worked.

What kind of care? About half of working mothers rely primarily on non-market child care provided by a relative. Studies show that a reduction in the price of child care is associated with an increase in the probability that a working mother will purchase paid care. This may be because those mothers who choose to work when the price of care decreases are more likely to use paid care; also, those already working may choose to substitute paid care for non-market care. Once the decision is made to use paid child care, however, reductions in the price of care or in the price of higher quality care do not appear to induce parents to purchase higher quality care.

Implications. Increased demand for child care will most likely be met by commensurate increases in supply at roughly current prices. However, if they must pay the market price for child care, many low-income parents find child care costs a barrier to employment and a substantial financial burden if they do take a job. Policies that decrease the price of care reduce this burden and encourage more mothers to work; they may also lead working mothers to switch from unsubsidized to subsidized care.

20% compliance

CDCTC "support test" — must pay half (not counting ~~EITC~~ AFDC)

1) Not adjusted for inflation since 1982

Single parent child >18,000

Two-parent w/ child >15,000

amounts + income ranges

income ranges — where it hits 30%

phase out %

raise amounts

Treasury will provide options

2) ~~Re~~fundability

- verifying expenditures

Subsidies

[how to double or triple]

DCAP

- who's getting them

often unionized ~~[illegible]~~ companies + upper income people

Meeting on Child Care Tax/Subsidy Issues
Friday, August 8, 1997 3:00pm
AGENDA

I. Dependent Care Tax Credit

II. Child Care Subsidies

III. Tax Credits to Employers that Construct/Expand/Renovate/Operate Child Care Facilities

IV. IRS Code Section 129 Plan (Dependent Care Assistance Plan)

V. Child Care Cost/Benefit Analysis and Survey of Literature

VI. Other

Refundable Child and Dependent Care Tax Credit

A refundable tax credit allows a taxpayer to receive the full benefits of a subsidy through the tax system, even if the subsidy exceeds his or her tax liability. The earned income tax credit is an example of a refundable tax credit. Low-income working taxpayers are able to receive the full EITC to which they are entitled, even if they have little or no individual income tax liability. Taxpayers can claim the refundable credit on their tax return filed at the end of the year and receive the value of the credit as either a reduction in their outstanding tax liability or as a refund.

Pros

- Making the credit refundable will increase the share of federally-assisted child care benefits accruing to low-income families.

Cons

- Families need funds for child care assistance in "real time." But most recipients will not be able to obtain the credit until they file a tax return at the end of the year, long after the child care bills have come due. To address this concern, advance payments of the credit could be made available, but experience with the EITC suggest that most taxpayers will not take advantage of this option. Eligibility for advance payments may be difficult to verify, unless a government office or employer is required to monitor claims.

- The IRS cannot verify child care expenditures prior to the payment of the credit to the taxpayer, but will not find it cost-effective to recapture erroneous payments to lower-income taxpayers with small tax liabilities. A social service office may be better able to check the authenticity of child care expenditures prior to paying out a voucher.

- Efforts to create new refundable credits have led to intensified scrutiny of the EITC and its compliance problems. The EITC provides a credit of $3,656 to families with two or more qualifying children with incomes between $9,140 and $11,930. The credit for families with one child and income between $6,500 and $11,930 is $2,210. The credit has been sharply attacked by Congressional critics in recent years (and will be attacked again this Fall).

  -- In the income range where making the child credit refundable matters, the EITC exceeds substantially the sum of income and payroll taxes. Hence, critics of a refundable child credit will be quick to label these payments "welfare" and vigorously fight this proposal.

Office of Tax Analysis
August 7, 1997

Child and Dependent Care Tax Credit

Current Law

A taxpayer who incurs expenses for the care of a qualifying individual in order to work is eligible for a nonrefundable tax credit. A nonrefundable tax credit offsets income tax liability only. Taxpayers with little or no income tax liability will not be eligible for the full amount of the credit. Generally, taxpayers with incomes below the poverty level do not have an income tax liability and thus would not qualify for the child and dependent care tax credit.

In general, a qualifying individual is (1) a dependent of the taxpayer who is under the age of 13[1]; (2) a dependent of the taxpayer who is physically or mentally incapable of taking care of himself or herself; or (3) the spouse of the taxpayer if the spouse is physically or mentally incapable of taking care of himself or herself. To qualify for the credit, a taxpayer must provide over half the costs of maintaining the household in which the taxpayer and the qualifying individual reside. In order to qualify for a dependency exemption and thus the credit, the taxpayer must also provide over half the support of the qualifying individuals. The taxpayer may not count public assistance (e.g., TANF benefits) as counting toward his or her contribution for the support of the dependent or the maintenance of the household.

For purposes of the nonrefundable credit, employment-related expenses are limited to $2,400 for one qualifying individual and $4,800 for two or more qualifying individuals. Taxpayers with adjusted gross income of $10,000 or less are allowed a credit equal to 30 percent of eligible employment-related expenses. For taxpayers with adjusted gross incomes of $10,000 to $28,000, the credit rate is reduced by one percentage point for each $2,000 or fraction thereof above $10,000. The credit is limited to 20 percent of employment-related child and dependent care expenses for taxpayers with adjusted gross incomes above $28,000. (These dollar amounts are not indexed and have not been adjusted for inflation since 1982.)

As a consequence of the Family Support Act of 1988, taxpayers are required to report the taxpayer identification number (e.g., the social security number) of their child care provider.

Related Proposals

In April, the Treasury Department announced various tax simplification proposals, including provisions to eliminate the household maintenance test for the child and dependent care tax credit and to allow taxpayers to more easily claim custodial children as dependents without meeting the support test.

---

[1] Qualifying individuals may include children who could have been claimed by the taxpayer, but the taxpayer waived the dependent exemption in order to allow the non-custodial parent to claim the children.

Facts about the Credit

- In calendar year 1994, 6 million taxpayers claimed $2.5 billion of child and dependent care tax credits. The average credit claimed was $420. In FY 1998, the cost of the credit is estimated to rise to $2.8 billion.

- Of the 6 million taxpayers claiming the credit in 1994, 4.2 million filed joint returns ($1.7 billion, average credit of $407), and 1.7 million filed as heads of households ($800 million; average credit of $453).

- About one-third of claimants in 1994 had adjusted gross income less than $30,000, while 15 percent had adjusted gross income in excess of $100,000.

- Less than 10,000 claimants had adjusted gross income less than $10,000 and qualified for the maximum credit rate of 30 percent.

- In 1988, 9 million taxpayers claimed the credit. Some have attributed the decline in participation to the requirement in the Family Support Act that taxpayers provide the taxpayer identification number of their child care provider when claiming the credit; however, it is not known the extent to which this provision, as opposed to other eligibility changes in the 1988 Act, contributed to the decline in participation. Because the IRS has not conducted a comprehensive compliance study since 1988, the effects of the TIN reporting requirement are not known.

- Information is not readily available from tax returns regarding the extent to which the credit is used for the care of children, disabled dependents, or disabled spouses.

Office of Tax Analysis
August 7, 1997

Exclusion of Employer Contributions for Child Care Expenses

Sec. 129

Current Law

Employers are allowed to exclude the provision of child and dependent care benefits from employees' taxable income and social security earnings. Child and dependent care assistance is defined as an employer's payment of, or provision for, the employment-related dependent care expenses of its employees and includes employer contributions through cafeteria plans.

The exclusion is limited to $5,000 of child care expenses and does not vary with the number of qualifying dependents. The amount of the expenses eligible for the child and dependent care credit is reduced dollar for dollar by the amount of expenses excludable from that taxpayer's income under the child and dependent care exclusion. The benefit of the exclusion to the taxpayer depends on both the amount of qualifying expenses and his or her income and payroll tax rate.

Various rules prevent highly compensated employees or part-owners from receiving a disproportionate amount of tax-preferred employer provided child care assistance. First, no more than 25 percent of the amounts paid by the employer for dependent care assistance may be provided for a group of shareholders who each own more than 5 percent of the capital or stock of the company. In addition, non-discrimination rules prevent highly compensated employees from receiving benefits which are far more generous than those received by lower-paid workers. A firm cannot provide dependent care benefits to non-highly compensated employees which, on average, are worth less than 55 percent of the average benefits provided to highly-compensated employees. Further, employers are not permitted to discriminate with respect to eligibility or benefits when providing benefits, including child and dependent care assistance, to employees through a cafeteria plan.

Facts about the Exclusion

- In FY 1998, the tax expenditure for the exclusion of employer provided child and dependent care is estimated to be $890 million.

Office of Tax Analysis
August 7, 1997

Other Tax Provisions Affecting Children

Dependent Exemption

A taxpayer may claim another individual as a dependent if the following five tests are met: (i) the dependent is within a specified relationship with the taxpayer (e.g., a child) or is any other individual who has resided with the taxpayer a full year; (ii) the dependent's gross income is less than the exemption amount, except that children are exempted from this test if they are under the age of 19 (or 24 if a full time student); (iii) the taxpayer provides over half of the dependent's total support; (iv) the dependent does not file a joint return; and (v) the dependent is either a U.S. citizen or a resident of the U.S., Canada, or Mexico. For purposes of determining whether a taxpayer provides over half of an individual's support, public assistance payments are taken into account as support payments made by a governmental authority.

In the event of divorce or separation, the custodial parent is generally entitled to the dependent exemption if both parents provide over half the support of the child. To qualify as the custodial parent, the taxpayer must reside with his or her child for over half the year. The custodial parent may waive the exemption to the noncustodial parent by providing the noncustodial parent with a written waiver.

In 1997, the value of the exemption is $2,650. The benefit to the taxpayer depends on his or her marginal tax rate.

Earned Income Tax Credit

Low-income workers may be eligible for the refundable earned income tax credit (EITC). The amount of the EITC depends on whether the worker has one, more than one, or no children. The credit initially increases with earned income, then remains constant as earned income rises, and finally decreases with adjusted gross income (or earned income, if greater) until it is fully phased out.

For purposes of the earned income tax credit (EITC), a child is a qualifying child if the following three requirements are met: (i) the child must be the son, daughter, grandchild, or foster child of the taxpayer; (ii) the child must generally reside with the taxpayer in the U.S. for over half the year (or a full year in the case of a foster child); and (iii) the child must be under the age of 19 (or 24 if a full-time student). In addition, if more than one taxpayer satisfies the age, relationship, and residence tests with respect to the same child, only the taxpayer with the highest adjusted gross income can claim the child.

The parameters of the credit depend on the number of qualifying children claimed by the taxpayer. For 1997, the parameters are as follows:

Credit Parameters	Two or More Qualifying Children	One Qualifying Child	No Qualifying Child
Credit rate	40 percent	34 percent	7.65 percent
Earnings at which maximum credit reached	$9,140	$6,500	$4,340
Maximum credit	$3,656	$2,210	$332
Phase-out begins	$11,930	$11,930	$5,430
Phase-out rate	21.06 percent	15.98 percent	7.65 percent
Income cut-off	$29,290	$25,760	$9,770

Child Credit

Under H.R. 2014, taxpayers will become eligible for a $500 child credit ($400 for tax year 1998) for each qualifying child under the age of 17. A qualifying child is defined as an individual for whom the taxpayer can claim a dependency exemption and who is the son, daughter, grandchild, or foster child of the taxpayer.

The credit is gradually phased-out for taxpayers with adjusted gross income over $110,000 ($75,000 if single or head of household).

The child credit generally cannot exceed income tax liability (prior to the earned income tax credit). However, taxpayers with three or more children may qualify for a refundable credit amount, equal to the amount by which the child credit exceeds their payroll taxes (employee contributions only), net of the earned income tax credit.

Office of Tax Analysis
August 7, 1997

Tax / Subsidy Child Care Meeting

Name	Agency	Phone	Fax
Sarah Reber	CEA	395-5618	5-6809
Amy Finkelstein	CEA	395-5147	"
Cynthia Rice	DPC - White House	456-2846	456-7431
Jon Gruber	Treasury	622-0563	622-2633
Gus Faucher	Treasury	622-0714	622-1294
Maria Hanratty	Treasury	395-6982	5-6809
Michael Barr	Treasury	622-0016	622-5672
Karl Scholz	Treasury	622-0120	6220506
Peter Orszag	NEC	456 5358	456 2223
Jennifer Appleton	HHS - ASPE	401-6614	690-5514
Matthew McKearn	OMB	395-7760	395-0851
Jennifer Friedman	OMB	395-7763	395-0851
Lauren Griffin	HHS - Legislation	690-6311	690-8425
Barbara Bizken	HHS - Child Care Bur.	401-5145	690-5600
Joan Lombardi	Child Care / ACF	401-6947	401-6947
Nicole Rabner	DPC / OFL	456-7263	456-2878

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Joan Lombardi	Child Care/ACF	401-6947	401-6947
Nicole Rabner	DPC/OFL	456-7263	456-2878

VERY PRELIMINARY OPTIONS TO MODIFY CHILD AND DEPENDENT CARE TAX CREDIT

Current Law

Child and Dependent Care Tax Credit -- A taxpayer who incurs expenses for the care of a qualifying individual -- a dependent child under 13 or an incapacitated adult dependent or spouse -- in order to work is eligible for a nonrefundable tax credit. Taxpayers with adjusted gross income of $10,000 or less are allowed a credit equal to 30 percent of eligible employment-related expenses. For taxpayers with adjusted gross incomes of $10,000 to $28,000, the credit rate is reduced by one percentage point for each $2,000 or fraction thereof above $10,000. The credit is limited to 20 percent of employment-related child and dependent care expenses for taxpayers with adjusted gross incomes above $28,000. Employment-related expenses are limited to $2,400 for one qualifying individual and $4,800 for two or more qualifying individuals. The maximum value of the credit ranges from $480 to $720 for a taxpayer with one child and $960 to $1,440 for a taxpayer with two or more children. (The dollar amounts are not indexed.)

To qualify for the credit, a taxpayer must provide over half the costs of maintaining the household in which the taxpayer and the qualifying individual reside. In order to qualify for a dependency exemption and thus the credit, the taxpayer must also provide over half the support of the qualifying individuals. The taxpayer may not count public assistance (e.g., TANF benefits) as counting toward his or her contribution for the support of the dependent or the maintenance of the household.

Exclusion for Employer Provided Contributions for Child and Dependent Care -- Employers are allowed to exclude the provision of child and dependent care benefits from employees' taxable income and social security earnings. Child and dependent care assistance is defined as an employer's payment of, or provision for, the employment-related dependent care expenses of its employees and includes employer contributions through cafeteria plans. The exclusion is limited to $5,000 of child care expenses and does not vary with the number of qualifying dependents. The amount of the expenses eligible for the child and dependent care credit is reduced dollar for dollar by the amount of expenses excludable from that taxpayer's income under the child and dependent care exclusion. The benefit of the exclusion to the taxpayer depends on both the amount of qualifying expenses and his or her income and payroll tax rate.

Description of Options

Option 1

Taxpayers generally would no longer be required to provide over half the costs of maintaining the home in which the taxpayer and the qualifying child reside to claim the child and dependent care tax credit. They would still be required to demonstrate that they reside in the same household as the child. A married taxpayer who files a separate return would still have to meet the current law household maintenance test in order to qualify for the credit. (This option was included in the Treasury Department's "Tax Simplification Proposals," released in April, 1997.)

Option 2 tax liability @ $11,000

single parent one child

Beginning in 1998, the credit rate would be 30 percent of qualifying child care expenses for taxpayers with adjusted gross income of $17,000 or less. For taxpayers with adjusted gross income between $17,000 and $44,000, the credit rate would be reduced by one percentage point for each $3,000 or fraction thereof above $17,000. The credit rate would be limited to 20 percent of employment-related child and dependent care expenses for taxpayers with adjusted gross incomes above $44,000. The amount of qualifying child and dependent care expenses would be increased from $2,400 to $2,500 for one child and from $4,800 to $5,000 for two or more children. Both the beginning point of the phase-down range and the maximum amount of qualifying child and dependent care expenses would be indexed in subsequent years.

More equity w/ $5000 employer credit $2 1/2 bi '99-03

Option 3

Option 2 with the following modification. Taxpayers could claim up to $4,000 of child care expenses with respect to a qualifying child under the age of six ($8,000 if they have two or more qualifying children under the age of six). The maximum amount for qualifying child care expenses for preschool children would be indexed in subsequent years. Another $1.5 bi

Option 4

The child and dependent care tax credit would be made refundable beginning in 1998. However, the credit rate and the amount of allowable expenses would not be changed.

Option 5

The credit rate, applicable to qualifying child and dependent care expenses, would be increased to 30 percent for all eligible taxpayers. In addition, qualifying child care expenditures would be increased to $2,500 for one child and $5,000 for two or more children.

Very Preliminary Revenue Estimates

	FY 1999 to FY 2003
Option 1:	-$300 million
Option 2:	-$2.5 billion
Option 3:	-$4 billion
Option 4:	-$4.5 billion
Option 5:	-$6 billion

Effects of Options

Option 1 -- Treasury Simplification Proposal (Released April 1997)

- A working parent could be eligible for the credit for child care expenses, even if he or she resided in their parents' home. The child and dependent care tax credit is an adjustment for employment-related child care expenses and should not also be based on a taxpayer's ability to maintain a home.

- Under this proposal, taxpayers would no longer need to demonstrate that they maintained a household in order to claim the child and dependent care tax credit. As a consequence, a single parent or married couple, who reside in another taxpayer's home, would be able to claim these tax benefits if they incur child care costs in order to work. In combination with a Treasury proposal to simplify dependency definitions (also included in the April 1997 package), some welfare recipients would also be able to claim the credit if they worked.

- Under current law, single taxpayers are required to meet two separate household maintenance tests for head of household filing status and for the child and dependent care tax credit. Married couples are generally not required to meet a household maintenance test, except to claim the child and dependent care tax credit. By eliminating the household maintenance test for the child and dependent care tax credit, the proposal would reduce record-keeping for both single and married workers with children.

- The proposal eliminates 6 lines from the instructions to the form 2441 and about half a page (or 81 lines) from publication 503 (Child and Dependent Care Expenses).

- Single working parents, who cannot afford to live on their own and who may be making the transition from welfare to work, would be the primary beneficiaries of the proposal.

Options 2 and 3 -- Increase Child and Dependent Care Tax Credit Dollar Parameters

Pros:

- The child and dependent care tax credit parameters have not been adjusted for inflation since 1982. As a result, very few taxpayers are eligible for the maximum credit rate of 30 percent.

- About half of those claiming the child and dependent care credit have expenses above the maximum limits and would benefit if the maximum amount of qualifying expenses was increased above $2,400 ($4,800 for two children).

- Increasing the amount of qualifying expenses to $4,000 for parents with preschoolers would adjust the limitation for inflation since 1982 and provide parents with a reasonable adjustment for the costs of child care provided through centers. According to HHS, child care provided through centers costs about $3,700 in 1996.

- Option 2 targets assistance to lower and moderate-income families, who would benefit from an increase in the credit rate.

- By increasing the credit rate for families with incomes below $44,000, this option particularly benefits single parents. Single parents may face special problems finding child care, because they may not be able to share child care responsibilities with the noncustodial parent.

  -- In 1994, over 90 percent of single parents claiming the child and dependent care tax credit had adjusted gross income under $50,000. In contrast, about 46 percent of married couples claiming the child and dependent care tax credit had adjusted gross income under $50,000.

- The welfare reform act increases mandatory spending on child care for very low-income families. An expanded child and dependent care tax credit will assist those families who no longer qualify for block grant funds (the near-poor, in particular), because their incomes have increased as they gain work experience.

Cons:

- Families need funds for child care assistance in "real time." But most recipients will not be able to obtain the credit until they file a tax return at the end of the year, long after the child care bills have come due.

- The IRS will generally be unable to verify child care expenditures prior to the payment of the credit to the taxpayer, but will not find it cost-effective to recapture erroneous payments to taxpayers. A social service office may be better able to check the authenticity of child care expenditures.

- Given the costs of quality child care, low-income workers are more likely than higher-income taxpayers to rely on informal (non-cash) child care arrangements. A small tax credit is not likely to change low-income mothers' reliance on their relatives and friends to care for their children in their absence.

- Raising the credit rate only for taxpayers with incomes below $44,000 may be viewed as an increase in the marriage penalty.

Option 4 -- Make Child and Dependent Care Tax Credit Refundable

Pros:

- Making the credit refundable will increase the share of federally-assisted child care benefits accruing to low-income families, particularly those with income below the poverty level.

- Among working mothers who pay for child care, low-income working mothers typically spend a greater share of their income for child care than those with higher incomes. In 1991, working mothers with child care expenditures and income below the poverty level spent 27 percent of their family income on child, while those with higher income spent 7 percent.

Cons:

- Families need funds for child care assistance in "real time." But most recipients will not be able to obtain the credit until they file a tax return at the end of the year, long after the child care bills have come due. Low-income families may find it difficult (if not impossible) to rearrange their finances or borrow against the receipt of a tax credit at the end of the year.

  -- To address this concern, advance payments of the credit could be made available, but experience with the EITC suggest that most taxpayers will not take advantage of this option. Eligibility for advance payments may be difficult to verify, unless a government office or employer is required to monitor claims.

- The IRS cannot verify child care expenditures prior to the payment of the credit to the taxpayer, but will not find it cost-effective to recapture erroneous payments to lower-income taxpayers with small tax liabilities. A social service office may be better able to check the authenticity of child care expenditures prior to paying out a voucher.

- Efforts to create new refundable credits have led to intensified scrutiny of the EITC and its compliance problems. The EITC provides a credit of $3,656 to families with two or more qualifying children with incomes between $9,140 and $11,930. The credit for families with one child and income between $6,500 and $11,930 is $2,210. The credit has been sharply attacked by Congressional critics in recent years (and will be attacked again this fall).

  -- In the income range where making the child credit refundable matters, the EITC exceeds substantially the sum of income and payroll taxes. Hence, critics of a refundable child credit will be quick to label these payments "welfare" and vigorously fight this proposal.

Option 5 -- Increase Maximum Credit Rate to 30 Percent

Pros:

- A uniform credit rate for the child and dependent care tax credit would reduce some of the marriage penalties in the tax code.

- The current tax treatment of child and dependent care expenses creates some inequities among taxpayers and adds complexity in the tax code. A higher, uniform rate for the child and dependent care tax credit may reduce these inequities and simplify tax administration.

  - Under current law, the exclusion is applicable to both income and payroll taxes. Many families may fare better with the exclusion than under the credit, because their combined income and payroll tax rates exceed the value of the credit rate. Some families (including some low-income taxpayers) may fare better under the credit because the credit rate is higher than their combined income and payroll tax rates.

  - As a consequence, the exclusion raises both equity and simplification concerns. Taxpayers can only benefit from the exclusion if they work for an employer who provides child care assistance. Taxpayers who have a choice must compute and compare the value of the tax preference under both the exclusion and the child and dependent care tax credit in order to determine which is more beneficial.

  - The option would make the child and dependent care tax credit more beneficial for many low and moderate-income workers than the exclusion. In many cases, it would be easier for taxpayers to understand that the child and dependent care tax credit was more beneficial, without having to compute and compare their tax liability under both provisions. Further, the more beneficial child and dependent care tax credit would be available to all working taxpayers, regardless of whether or not they worked for an employer who provided child care benefits.

- Taxpayers would no longer have to use a look-up table, which was irrelevant to most, to determine the applicable credit rate.

Cons:

- This option does not target assistance to low-income families. Taxpayers with incomes below or at the poverty level would not benefit from this option. Even working families with incomes slightly above the poverty level would receive a smaller tax cut than those with higher incomes.

Office of Tax Analysis
August 19, 1997

Elena -

do these phaseouts below 25? 21.5?

OPTIONS

INCREASING SUBSIDY TO SERVE MORE CHILDREN

In FY 95, the four federal child care programs were funded at $2.16 billion. Below is the most recent data from that year on the number of children served in each program:

Program	Children served
AFDC/JOBS	233,029 average per month
AFDC/non-JOBS	209,020 average per month
TCC	141,017 average per month
ARCC	189,891 average per month
CCDBG	662,735 per year

An exact total number of children served with these four programs is not available since numbers from each program cannot be combined due to differences in data collection methodology and lack of information about duplication across data sets.

No current data is yet available on the number of children served by the new unified CCDF program funded at $2.9 billion in FY 97. Since states have a great deal of flexibility in critical policy areas, we do not yet know how many children will be served. **Numbers of children served will depend on state decisions regarding: reimbursement rates, parent co-payments, age of children served, how much is spent on quality and amount of state investment.** Rough estimates are that these funds provide a little more than one million slots. Each slot could serve more than one child a year, since children may move in and out of the system.

→ Do states have to report how many children they serve?

1. <u>Increase the number of children served with current policies</u>

Under this option, states would be allowed to continue to set all policies with regard to eligibility, reimbursement rates, co-payments, targeting, etc. A specific amount of funds would be added to reach a targeted number of children.

For example, one goal could be to double the number of children over the next five years, reaching approximately 2 million children by the year 2002.

9/97

Advantages:

- o Maintains flexibility provided in existing statute for States to tailor program to meet specific State or local needs.
- o Avoids additional regulatory and administrative requirements, e.g. tracking additional "pots" of funding in financial management, reporting, program design.

→ what about link add'l funds to state quality standards?

Disadvantages:

- o Forfeits opportunity to target use of funds to foster national goals.

2. <u>Increase number of children served and target specific ages of children</u>

A. <u>Provide additional funding targeted to care for infants and toddlers.</u>

Advantages:

- o The care infants receive will influence their later lives.
- o Available infant care will also ensure that young families are served, e.g., teen parents with very young children.
- o Targeting infants particularly could help bolster the supply of providers in this area of shortage.
- o Given that, under Temporary Assistance for Needy Families (TANF), States will require parents with very young children to work, the demand for care for very young children may increase dramatically.
- o Under new welfare requirements, parents are required to go to work or attend training when their child is 3 months old. States may choose to exempt parents of children under age 1 from these work requirements. However, many states have are requiring families to work with children under age 1.
- o A recent GAO study found that communities are generally not meeting current demand for infant care. The study found that the percentage of current demand for infant care that is met by the known supply ranges from 16% to 67%, with the gap being particularly great in poor communities.

Disadvantages:

- o Since infants require more specialized care and more individual attention, child care for infants typically is more expensive.
- o There are fewer providers of infant care. There would be a need to assure supply of slots as well the availability of infant child care subsidies.

B. <u>Target additional funding to school-age child care.</u> There is a prevailing lack of school-age child care, especially in low-income area.

Advantages:

- o School-age care will provide adult supervision so that children will not be alone, keep them off the streets, and ideally, provide them with a range of positive and enriching experiences during out-of-school time.

- o School-age child care costs less than pre-school care, and therefore more children could be served.

Disadvantages:

- o If only school-age child care is targeted, infant and toddler child care, which is expensive and critical to young children's development, might not expand.

<u>3. Increase number of children served and target non-welfare families.</u>

Under this option, all new funds could be directed at non-welfare families. Funds could also be targeted to promote other policy goals such as affordable co-payments and higher reimbursement rates.

Advantages:

- o Would provide a greater degree of assurance that child care assistance is available for non-welfare working families and not disproportionately targeted to TANF families.

Disadvantages:

- o Depending upon the program design could impede State flexibility by making artificial distinctions between categories of families. There is little practical distinction between low-income working families (non-welfare families) and working families who also receive assistance. Low income non-welfare families frequently cycle on and off of assistance (the "one paycheck away from welfare" dilemma of the minimum wage worker) so this artificial categorization is not useful.

- o Targeting low-income working families is unnecessary as there are adequate provisions in the current law to ensure that they are served. ?

BACKGROUND

THE CHILD CARE AND DEVELOPMENT BLOCK GRANT

The **Child Care and Development Block Grant (CCDBG)** is the primary Federal subsidy program specifically devoted to child care. It enables low income parents and parents receiving Temporary Assistance for Needy Families (TANF) to work or to participate in the educational or training programs they need in order to work. Funds may also be used to serve children in protective services.

PRWORA consolidated four child care subsidy programs: AFDC/JOBS Child Care, Transitional Child Care, At-Risk Child Care and the Child Care Development Block Grant. Funds are now available to states in three parts: mandatory funds (based on historical levels of funding for the entitlement programs), matching funds, and discretionary funds. A single lead agency must be identified at the state level to administer the CCDBG funds.

The new CCDBG provides increased Federal funding for child care over past programs--some $4 B additional over the life of the new law (FY 97 - FY 2002) for a total of around $22 B. The preponderance of the funds are distributed to States to operate child care subsidy programs and improve the quality and availability of child care.

<u>Funding to the States - FY 1997</u>

FY 97 funding for CCDBG is $2.9 billion:

In FY 1997, States received close to $1.2 B in Mandatory Funds.

- o These are 100% Federal funds. A State's share of these Funds is based on the Federal share of its funding for the now-repealed AFDC-linked child care programs (AFDC/JOBS Child Care, Transitional Child Care, At-Risk Child Care). The share is based on Federal funds received in FY 1994, FY 1995, or an average of FY 1992-1994, whichever is greater.

States also are eligible to receive a little over $.7 B in Matching Funds in FY 1997.

- o These funds are available using a proportional child population formula that was used in the former At-Risk Child Care Program.

9/97

- In order to receive matching funds, a State must maintain effort, i.e., expend its own funds at the level it was matching the former AFDC-linked child care programs in FY 1994 or FY 1995, whichever is greater. A States must also provide matching funds at the Medicaid match rate.

A little over $.9 B in Discretionary Funds, appropriated in FY 1997, will be distributed to the States in FY 1998.

Statutory Limits and Requirements on State Expenditures

States must spend at least 70% of their Mandatory and Matching Funds on families on TANF, transitioning from TANF, or at-risk of becoming eligible for TANF. They are required to demonstrate how they serve those populations in their CCDF Plan. States define the term "at-risk".

States must spend at least 4% of their CCDF funds (Discretionary, Mandatory, and State and Federal share of the Matching Funds) on activities to improve the quality and availability of child care. Under the old AFDC-related programs, there was no quality expenditure requirement. Under the original CCDBG, States were required to spend 25% of their funds on quality activities and activities to increase the supply of before- and after-school care and early childhood development programs.

States must spend no more than 5% of their CCDF funds (Discretionary, Mandatory, and State and Federal share of the Matching Funds) on administration.

Eligible Families

By statute, States can serve families whose parents are working or in education or training, and families whose children are receiving protective services.

By statute, States can serve families whose income level is up to 85% of the State median income (SMI) for a family of the same size.

- Based on a preliminary analysis of plans submitted for the FY 1998-1999 biennium: 10 States placed eligibility levels at up to 85% of the SMI and some 30 additional States set eligibility levels in the 50% through 80% range.

- The most recent data indicates that the majority of federal child care subsidy serves children below 130 percent of poverty.

Eligible Children

By statute, a State can serve children under age 13.

- In Fy 1995, 64% of children served through the CCDBG (now the Discretionary Fund of the CCDF) were age 5 and under, 35% were age 6-12, and 1% were over age 13.

- By regulation, a State may serve children age 13 and over who are under court supervision or are mentally or physically incapable of self care. In ACF's preliminary analysis of the current draft FY 1998-1999 CCDF Plans, we found that 60% of States indicate they will serve children under court supervision. Some 90% will serve children who are incapable of self care.

- By statute, States must give priority to children with special needs and to children from very low income families. States have the flexibility to define "special needs" and "very low income."

- States can also give priority to other categories of children. A preliminary analysis of State plans for the upcoming biennium shows that States additionally have chosen to give priority to such categories as teen parents, families in protective services, and families receiving TANF.

How Families Receive Subsidies and Contribute to the Cost of Care

Families apply for child care subsidies through their local child care resource and referral offices, local welfare offices, family day care network offices or other agents of the Lead Agency.

The statute requires parental choice of provider. Any legally operating child care provider may be chosen. The main categories of child care are center-based care, family day care homes, group family day care homes, and in-home care. Sectarian care and relative care are permissible choices, as well as any other types of legal provider.

The statute requires that the family offered CCDBG-subsidized care be given the choice to enroll the child with a provider that has a grant or contract to provide services or to receive a child care certificate. A certificate is defined in the statute as a check or other disbursement that is issued by a Sate or local government under the statute directly to a parent who may use the certificate only as payment for child care services. Some States run all-certificate programs. Others offer a mixture of certificates and grants or contracts.

By statute, a State's CCDBG Plan shall certify that payment rates for the provision of child care services for which assistance is provided are sufficient to provide equal access for eligible children to comparable child care services in the State or substate area that are provided to children whose parents are not eligible to receive assistance. States must provide a summary of the facts used to determine that the rates are sufficient to provide equal access.

The statute requires that the family contribute to the cost of care on a sliding fee basis. The CCDBG Plan must include the scale or scales used to determine the family's contribution. The statute requires that the scale be based on family size and income. The State may add other factors, e.g., the number of children in care, rules for counting income. By regulation, States may exempt families below the poverty level from paying the co-payment.

How recent? Recent reports by the Census Bureau indicate that families with income below the poverty level pay a disproportionate share of their income--some 18%--for child care; whereas families above the poverty level pay only 7% of their income for child care. In the CCDBG proposed rules, ACF did not propose to limit the family co-payment. As part of its guidance on the statutory concept of "equal access," however, ACF has suggested in its preamble to the CCDF proposed rule that, as a benchmark, a State design its sliding fee scale(s) to require that a family spend no more than 10% of its income on child care, no matter how many children are in care.

<u>Quality of Care</u>

By statute, a State must certify that it has in effect licensing requirements applicable to child care services provided within the State. The State must describe those requirements in its CCDBG plan as well as how they are effectively enforced.

By statute, a State must certify that there are in place requirements designed to protect the health and safety of children that are applicable to the providers that serve CCDF children. The requirements shall include:

- **the prevention and control of infectious diseases (including immunization);**
- **building a physical premises safety; and**
- **minimum health and safety standards.**

All providers of care to CCDF children, therefore, must meet the basic health and safety standards--whether through licensure or regulation or through requirements designed by the Lead Agency to apply to unregulated care providers serving CCDF-subsidized families.

States must spend 4 percent of CCDF funds on Quality. Activities usually include efforts to expand and improve training, licensing and resource and referral and outreach and support to new providers.

States additionally have flexibility within the CCDF to create payment rates that reward higher quality care, such as establishing higher payment rates for accredited centers or other child care facilities or rewarding in-home providers with appropriate child care credentials.

Economic Effects of Child Care Policies

SUMMARY:

Increasing child care subsidies can be expected to increase mothers' labor force participation and the use of paid care, relative to non-paid care. There is little evidence on the effects of subsidies on child care quality. Subsidies have little effect on child care provider wages.

POSSIBLE GOALS OF A CHILD CARE POLICY:

Before arriving at a child care policy, it is necessary to determine what the goal(s) of the policy is (are). Different goals will require different approaches, and will have different distributional consequences. Possible economic rationales for a child care policy are to:

- Offset higher marginal tax rates, which may result from aggregation of income by dual-income couples.
- Provide for more "equal treatment of equals" in the tax code by allowing some adjustment for the costs of working.
- Provide income support for lower-income families where the parents use child care.
- Provide an incentive for parents to use higher-quality child care.
- Provide information to parents that allows them to choose higher-quality care.
- Increase the labor supply of parents, particularly those receiving public assistance.
- Increase the supply of child care services.
- Improve the skills of child care providers.

BACKGROUND:

A number of economic studies have tried to estimate the effect of child care policies on the labor force participation of mothers, the use of various types of child care, and the quality of child care. The issue is a complicated one because many of the important underlying variables are endogenous (such as wages and labor force participation) and observed for only a subset of the sample (particularly wages and child care expenses), introducing the possibility of selection bias.

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Effects on Labor Supply

- There is a large body of evidence that reductions in the effective cost of child care will have a positive effect on the employment of mothers, although the magnitude is uncertain.

- However, the reduction in child care costs appears to have little effect on the actual *number of hours worked*.

- There is some evidence that the employment response is larger for poor women and single mothers than for the non-poor and married women.

- Table 1 summarizes research on the effects of child care costs on labor supply.

Effects on the Type of Care

- The demand for market-based child care (as opposed to informal, low-cost child care) is also responsive to reductions in formal child care costs. Government subsidization of formal child care encourages substitution of formal care for informal care ("crowdout").

- To the extent that subsidization results in a *change* in the method of care, rather than an increase in the amount of care, this "crowdout" is inefficient if the goal is to increase the labor supply of mothers.

- However, if the goal of the policy is to increase the incomes of the working poor, the subsidy serves as an income transfer and "crowdout" is less of a concern.

- There is also evidence that as family income increases, the demand for market-based care increases (market-based care is a normal good).

- Table 2 summarizes research on the effects of child care costs on the type of care chosen.

Effects on Quality of Care

- There is little good evidence on whether subsidies result in an increase in the quality of child care purchased; quality is difficult to measure objectively and the few studies do not present conclusive results.

- Although child care subsidies result in the substitution of paid for unpaid care, there is little evidence on the *type* of paid care purchased, or the magnitude of the quality difference between paid and unpaid care.

Supply of Child Care

- There is little research on the supply of child care. Child care workers have lower earnings than women with similar characteristics in other occupations and industries, and experience rapid job turnover.
- Wages for child care workers appear to be unresponsive to government policies, including supply subsidies, demand subsidies, and child care regulations.
- The few, small studies on child care workers have found that there are no economic returns to licensing, education, or experience.
- Given that the demand for child care is sensitive to price, provider standards that reduce the number of low-cost providers may drive families to "underground" child care and/or decrease female labor force participation, at least in the short-run.

Table I. The effect of child care costs on employment decision (all effects statistically significant unless indicated)

A. Studies that use an exogenous source of variation in the cost of child care

Study (year)	Data Source	Group studied	Source of variation in child care costs	Measure of labor supply	Measure of cost of child care	Estimate of employment effect
Berger and Black (1992)	Telephone survey	Low-income single mothers	Those receiving day care subsidy in two Kentucky programs versus those on subsidy waiting list.	Whether mother employed or not	Dummy for receipt of subsidy (amt of subsidy varies with income)	Attribute an increase in employment of 12% to program
Gustafsson and Stafford (1992) {sweden}	Swedish data set plus telephone survey	Families in different Swedish communities	Exogenous variation due to local government setting subsidy rates for public child care.	Whether mother works 'substantially' (more than 30 hours)	Locally-set price (per month) of public child care	Estimated mean elasticity of employment with respect to child care cost -1.88
Leibowitz et al. (1992)	NLS-Y	First-time mothers	Variation among states and over time in state and federal income tax credits for child care	Whether mother is employed when child is 3 months old, and whether mother is employed when child is 24 months	Subsidy available through state and federal income tax credits; to avoid endogeneity issues, assumes woman works full-time at her predicted wage	Greater tax credits increased early return to work (w/in 3 mos) but had little effect on employment of women with older children
Michalopoulos et al. (1992)	Wave 5 of 1984 SIPP	Subsample of working mothers who purchase care	Inter-state variation in child care tax credits	Hours of work	Subsidy rate calculated using federal and state tax codes; to avoid endogeneity issues, credit rate calculated assuming mother works 40 hours per week	Median elasticity of hours worked with respect to child care cost, conditional on mother working and purchasing child care, estimated at .0018 (not significant)

B. Studies that use an estimation of child-care costs

Study (year)	Data source	Group studied	Estimation procedure	Measure of labor supply	Measure of cost of child care	Estimated elasticity of employment with respect to child care costs
Blau and Robbins (1988)	1980 EOPP	Married mothers	Multinomial logit	Mother does not work versus four combinations of mother working with purchased care or not, other relatives working or not	Average child-care expenditures among families in the community who purchased care	-0.38 (calculated at means)
Connelly (1992)	Wave 5 of 1984 SIPP	Married mothers	Probit	Employed or not	Selectivity-corrected predicted hourly costs from employed who purchase care	-0.20 (calculated at means)
Ribar (1992)	Wave 5 of 1984 SIPP	Married mothers	Simultaneous maximum likelihood probit of labor force participation and tobit of demand for paid and unpaid child care services	ditto	ditto	-0.74 (calculated at means)

B. Continued

Study (year)	Data source	Group studied	Estimation procedure	Measure of labor supply	Measure of cost of child care	Estimated elasticity of employment with respect to child care costs
GAO (1995)	Urban Institute's 1990 National Child Care Survey and Low-Income Sub-study	Mothers in sample	Probit	ditto	ditto	-0.5 for poor mothers, -0.34 for near-poor mothers, and -0.19 for non-poor mothers.
Kimmel (1995)	1987 and 1988 SIPP data	Single mothers in poverty	Probit	ditto	ditto	-0.346. Also estimated elasticity separately for white single mothers in poverty (-1.362) and black single mothers in poverty (-.345; not statistically significant)
Cleveland et al (1996) {Canada}	1988 Canadian National Child Care Survey	Families with young children	Probit	Engaged in paid employment or not	ditto	-0.388
Averett et al. (1997)	1986 NLS-Y	Married mothers	Several different estimation procedures	Employed or not	ditto	Estimated elasticity varies with model specification but preferred method estimated elasticity as -0.78

Table 2. The effect of child care cost on demand for market-based child care
(see above tables for additional information on studies)

Study (date)	Measure of paid child-care utilization	Estimated elasticity of demand for market child care with respect to price of market care[1]	Comparison to estimated elasticity of employment
Blau and Robbins (1988)	Whether care is purchased or not	Conditional on the mother working, elasticity of purchased care is -0.34	-0.38
Gustafsson and Stafford (1992)	Participate in public (subsidized) child care system by enrolling child for 30 hours or more	-2.68 is the estimated elasticity of the joint decision to engage in market work and to purchase public care, compared to an elasticity of just -1.88 to work more than 30 hours	
Ribar (1992)	Whether use paid care or not	-1.86	-0.74
Cleveland et al. (1996)	Whether market care is purchased or not	-1.056	Over three times as great as the estimated elasticity with respect to employment (-.388)

[1] All effects statistically significant

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Connelly, Rachel. 1992. "The Effect of Child Care Costs on Married Women's Labor Force Participation.' *Review of Economics and Statistics*, February.

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Laura Emmett 08/25/97 04:15:59 PM

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To: See the distribution list at the bottom of this message

cc:
Subject: Child Care Mtg. on Tax/Subsidy Issues

There will be a Child Care Meeting on Tax and Subsidy Issues Wednesday, September 3, at 10:30 AM in room 211 OEOB. It will last about an hour and a half.

<u>Tax/Subsidy Issues</u> (Wednesday, September 3, 10:30 Room 211 OEOB)
Elena Kagan, DPC E-Mail
Jen Klein, DPC E-Mail
Cynthia Rice, DPC E-Mail
Nicole Rabner, DPC E-Mail
Peter Orszag, NEC E-Mail
Emil Parker, NEC E-Mail
Emily Bromberg, IGA E-Mail
Sky Gallegos, IGA E-Mail
Keith Fontenot, OMB E-Mail
Jeff Farkas, OMB E-Mail
Jennifer Friedman, OMB E-Mail
Laura Oliven Silberfarb, OMB E-Mail
Anne Lewis, NEC E-Mail
Sandy Korenman, CEA E-Mail
Amy Finkelstein, CEA E-Mail
Olivia Golden, HHS E-Mail
Joan Lombardi, HHS E-Mail
Shannon Rudisill, HHS E-Mail
Lauren Griffin, HHS E-Mail
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The Affordability Gap

Working Families and Child Care

Child Care, Inc.

Prepared by Amanda Cicarelli
with Natasha Lifton

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File - Child Care - Tax and Subsidy

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ASSISTANT SECRETARY FOR PLANNING AND EVALUATION

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Number of Pages + Cover 2

REMARKS Cynthia - Attached is the ~~lasto~~ latest child care table. I have no idea how relevant this is at this time, but nevertheless I wanted you to have the most current version. Call if you have questions.

- Jennifer

DRAFT

FAMILIES WITH CHILDREN ELIGIBLE FOR CHILD CARE ASSISTANCE

Family Income by Poverty Level (cumulative)	**Non-Welfare Working Families w/ Children <13 years**[1] (in millions)	**Welfare Families w/ Children <13 years Required to Enter Work-Related Activities under TANF**[2] (in millions)	**Families with Children Eligible for Child Care Assistance [Children Eligible for Child Care Assistance**[3]**]** (in millions)	**80% Utilization** (in millions)	**60% Utilization** (in millions)	**40% Utilization** (in millions)
Less than 100% of poverty	1.54	.60	2.14 [3.42]	1.71 [2.74]	1.28 [2.05]	.86 [1.38]
Less than 150% of poverty	3.23	.60	3.83 [6.13]	3.06 [4.90]	2.30 [3.68]	1.53 [2.45]
Less than 185% of poverty	4.61	.60	5.21 [8.34]	4.17 [6.67]	3.13 [5.01]	2.08 [3.33]
Less than 200% of poverty	5.19	.60	5.79 [9.27]	4.63 [7.41]	3.47 [5.55]	2.32 [3.71]

1. Non-welfare working families are defined as single parent families in which the parent is working at least part time, or two-parent families in which both parents are working at least part time. Source: March 1996 CPS, with CY 1995 income data.

2. Based upon a 25% work participation rate in 1997, it is estimated that an upper bound of 734,000 welfare families (with no adjustments for caseload reduction) are required to enter work-related activities under TANF. It is estimated that 82% of these families, or .60 million, have at least one child under 13. Historically, welfare families have income levels of less than 100% of poverty.

3. Numbers in brackets represent children eligible for child care assistance, assuming 1.6 children per family.

DHHS/ASPE/HSP--October 10, 1997 (4:35pm)