<u>Promoting Affordable Childcare for Everyone (PACE) Act</u>

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<u>Background</u>

- The PACE Act would enhance the two provisions in the federal tax code that help working families pay expenses associated with child care or dependent care, making the provisions more helpful to all working families and expanding them to more working families on the lower end of the income spectrum. The provisions are the Child and Dependent Care Tax Credit (CDCTC), set forth in Section 21 of the Internal Revenue Code, and the income exclusion for employer-sponsored child care, set forth in Section 129 of the IRC.

- The PACE Act is <u>necessary</u> because child care is very expensive, consuming a large percentage of a working family's annual income. In their current form, the CDCTC and the income exclusion do not do enough to help working families afford child care.

- The PACE Act is <u>important</u> because hit would help parents who work or are looking for work better afford child care, which helps children, parents, and the economy. It would build skills in young children, preparing them to succeed in school and the workforce. It would help close the achievement gap between children of different socio-economic backgrounds that exists by the time children start kindergarten. It would help parents build careers and income. It would strengthen families, communities, and the economy.

<u>Current Law</u>

- Currently, the CDCTC is a <u>non-refundable</u> tax credit that reduces a taxpayer's federal income tax liability based on child care or dependent care expenses incurred. Because the credit is non-refundable—meaning the dollar value of the credit cannot exceed a family's income tax liability—many lower-income families receive little or no credit.

- With respect to child care, the goal of the CDCTC is to assist taxpayers—with children under the age of 13—who work or are looking for work. The taxpayer must have earned income to claim the credit. Qualifying expenses include payments made for child care services provided inside the home—like payments to nannies, housekeepers, and relatives like grandparents—or outside the home—like day care, nursery school, preschool, and day camp. A taxpayer with one child can annually claim a maximum of $3,000 in qualifying child care expenses, and a taxpayer with two or more children can annually claim a maximum of $6,000 in qualifying child care expenses.

- The amount of the credit is calculated by multiplying the amount of qualifying expenses by a <u>credit rate</u>, which is on a sliding scale and ranges from 35% to 20%, with lower-income families receiving the higher percentage. For example, a taxpayer with adjusted gross income of $40,000 has a 21% credit rate. If that taxpayer has two children and the maximum of $6,000 in qualifying child care expenses, the taxpayer would be entitled to a non-refundable credit of $1,260 ($6,000 x .21).

- With respect to dependent care, the goal of the CDCTC is to assist taxpayers who are financially responsible for caring for a spouse or other dependent who is incapable of caring for themselves, and the credit caps and credit rates are the same as they are for child care.

- In addition to the CDCTC, taxpayers can exclude from their income up to $5,000 of employer-sponsored child and dependent care benefits. Benefits can be provided in various forms, like flexible spending accounts (FSAs) that allow employees to set aside a portion of their salary on a pre-tax basis to be used for qualifying expenses; direct payments by an employer to a child care center; on-site care offered by an employer; and employer reimbursement of employee child care costs.

- Since the value of these benefits is excluded from an employee's wages, it is not subject to income taxes or payroll taxes—and therefore lowers a taxpayer's tax liability.

The PACE Act

- The PACE Act would:

    - Make the CDCTC refundable, so a taxpayer can use the credit to reduce their federal tax liability to zero AND receive a refund from the IRS for any credit remaining. This will benefit many lower-income families that do not benefit, or benefit very little, from the current credit.

    - Increase the CDCTC credit rate by 15%, so the top rate is 50% (up from 35%) and the bottom rate is 35% (up from 20%)—helping all families who claim the credit. For example, according to estimates from CRS,

        - Under the PACE Act, a taxpayer with annual income of $30,000, two children, and $6,000 in child care expenses would receive a credit of $2,520, versus $1,620 under current law. The same taxpayer with $40,000 of annual income would receive a credit of $2,220, versus $1,320 under current law. The same taxpayer with $50,000 of annual income would receive a credit of $2,100, versus $1,200 under current law.

    - Adjust the CDCTC income levels and maximum credit amounts—$3,000 for a taxpayer with one child, $6,000 for a taxpayer with two or more children—for inflation, so that more families will be entitled to a higher credit.

    - Increase the maximum amount of the income exclusion for employer-sponsored child and dependent care to $7,500, up from the current $5,000, and adjust that amount for inflation going forward.