

# Proposal 10: Supporting Low-Income Workers through Refundable Child-Care Credits

James P. Ziliak  
*University of Kentucky*

## Introduction

Economic self-sufficiency through labor market work for low-income families, especially those headed by a single mother, formed a fundamental tenet of both the 1993 expansion in the Earned Income Tax Credit (EITC) and the 1996 Personal Responsibility and Work Opportunity Reconciliation Act (aka welfare reform). While both reforms have been credited with expanding employment of single mothers in the years immediately following implementation (Grogger 2003; Meyer and Rosenbaum 2001), employment rates of mothers with dependent children have been on a steady decline over the past decade, leaving many families unable to make ends meet (Blank and Kovak 2008; Bollinger, Gonzalez, and Ziliak 2009; Fox et al. 2013).

A key financial challenge facing these families is finding affordable child care. In 2012 the average annual cost for full-day, center-based care of an infant ranged from \$4,850 in Mississippi to \$16,450 in Massachusetts; for care of a four-year-old, the cross-state range was \$4,300 to \$12,350 (Child Care Aware of America 2013). As a fraction of average annual earnings among single mothers with children under the age of five, child-care costs amount to over one-fourth of earnings in Mississippi and over one-third of earnings in Massachusetts.<sup>1</sup> Evidence suggests that children do better in model, center-based care than in informal, home-based care on a host of cognitive and noncognitive measures (Bernal and Keane 2011; Blau and Currie 2006; Morris et al. 2009), and that women respond to reductions in effective child-care prices by

increasing their participation in the labor force (Baum 2002; Berger and Black 1992; Kimmel 1995; Tekin 2007).

This policy memo introduces a way to restructure an existing federal child-care tax credit to better incentivize work and improve the financial and child well-being for low-income families. Specifically, I propose converting the Child and Dependent Care Credit (CDCC) from a nonrefundable credit—a credit that cannot exceed the income taxes owed by a family—to a refundable credit—one that can result in a net gain after taxes—that is targeted to low- and middle-income families. Because current law does not limit eligibility for the CDCC based on income, the majority of tax expenditures are spent on those families with annual incomes between \$100,000 and \$200,000 (Maag 2013). I propose capping eligibility at \$70,000 and making the credit a progressive function of income, the age of the child (ages zero to four versus five to twelve), and utilization of certified, licensed care facilities. These reforms, to be implemented at the federal level, will make labor market work more attractive to low-income families by providing much-needed financial relief from the high cost of child care. In addition, by reducing the out-of-pocket cost of care for low-income workers, the reformed credit will enable more families to place children in formal instead of informal care settings.

## The Challenge

The fact that mothers are deterred from working in the labor market because of costly child-care options runs counter to

the national goal of economic self-sufficiency. To fix ideas on the evolution of employment in recent decades, figure 10-1 depicts employment rates of single and married mothers (by the education level of single mothers) with dependent children under the age of thirteen. This age range of children is selected because the presence of children under the age of thirteen is a requirement for two of the three major federal child-care assistance programs.<sup>2</sup> The data are drawn from the 1981–2013 Annual Social and Economic Supplement of the Current Population Survey, and employment refers to any reported paid work in the prior year. The huge surge in employment rates in the 1990s—which occurred coincident with the expansion of the EITC, the strong economy, and welfare reform—is most evident among single mothers with a high school education or less, and among those never married (of any education level). What is also striking in figure 10-1 is the secular decline in employment after 1999 and the relative absence of a cyclical effect even in the face of the Great Recession of 2007–2009. Employment rates in 2012 are about 10 percentage points lower than in 1999 for each group of single mothers, and about 7 percentage points lower for married mothers. In results not depicted, employment trends of mothers living in families with incomes below twice the poverty level are quite similar.

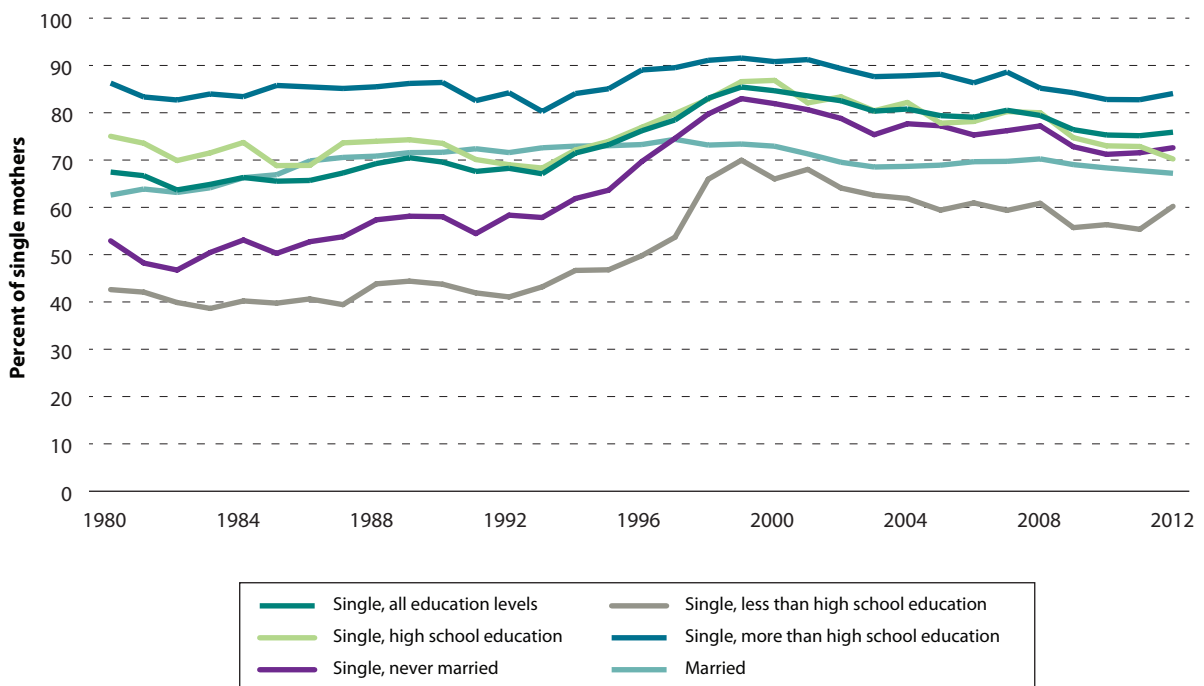
However, in a remarkable turn, the level of employment of poor and near-poor married women was lower in 2012 than it was in 1980.

Figure 10-2 presents a more disaggregated look at the employment status of single mothers with children under the age of thirteen by examining part-time and full-time work. The figure shows that, starting in the late 1980s, a plurality of single mothers were employed year-round and full-time, rising to 52 percent in 2000, but then falling steadily to 42 percent by 2012. In the past decade, the decline in full-time work (both full-year and part-year) has been mostly filled by an increase in the share not in the labor force (NILF), and to a lesser extent by an increase in full-year, part-time work. Since 2000 there has also been an increase in the fraction of married mothers with children under the age of thirteen not in the labor force; this mostly coincides with a decline in the fraction of married mothers working part-year, including those working both full-time and part-time.

The past decade has witnessed a significant shift away from employment among mothers, whether single or married, that was particularly pronounced among the less skilled and those with family incomes below twice the poverty level. While a

FIGURE 10-1.

### Employment Rate of Women with Children under Age 13, by Marital Status and Education

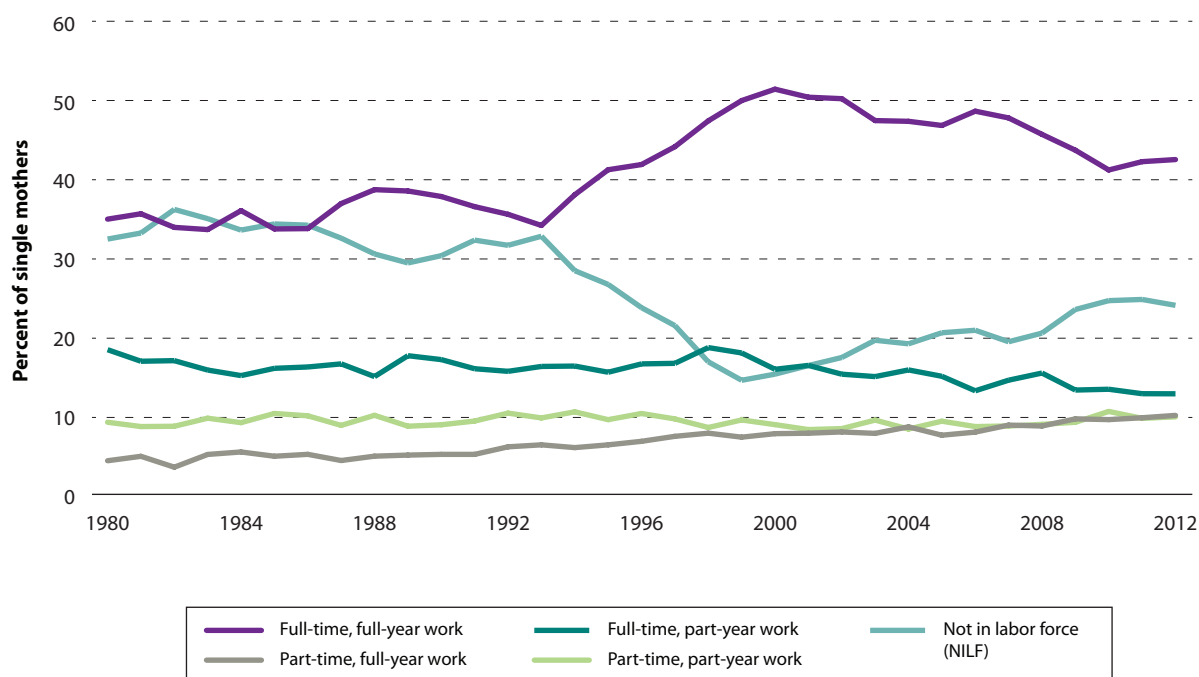


Sources: U.S. Census Bureau various years; author's calculations.

Note: Data is derived from the 1981–2013 Current Population Survey Annual Social and Economic Supplement.

FIGURE 10-2.

## Employment Status of Single Mothers with Children under Age 13



Sources: U.S. Census Bureau various years; author's calculations.

Note: Data is derived from the 1981–2013 Current Population Survey Annual Social and Economic Supplement.

full analysis of the reasons behind the decline in employment is beyond the scope of this paper, the high cost of child care, combined with stagnant real wages and other factors, might be a contributing factor. Table 10-1 presents median out-of-pocket child-care costs, the interquartile range of costs (75th percentile less 25th percentile), median family earnings, and median family income for working mothers pooled across the 2012 and 2013 waves of the Current Population Survey.<sup>3</sup> The table shows that even though the median out-of-pocket costs for child care among married mothers is about 80 percent higher than for single mothers, family earnings (mother plus spouse) of working married women are four times higher; as a fraction of earnings, the burden on single mothers is substantially higher at roughly 16 percent and 11 percent for those with children under age five and under age thirteen, respectively.

Figure 10-3 highlights the cross-state variation in the ratio of median out-of-pocket child-care costs to median earnings of single mothers with children under age five. The figure makes clear that the burden of child care is quite high in some states. At the median, child-care costs range from 6 percent of earnings in Alaska to 28 percent in Delaware, with twelve states clocking ratios of child care to earnings in excess of

20 percent. Note that these estimates are for any out-of-pocket child-care expenses and that if we were to limit the sample to only center-based child care, these ratios would be significantly higher.

## A New Approach

A restructured Child and Dependent Care Credit (CDCC) could encourage greater economic self-sufficiency and improve the economic well-being of low-income families. The federal government currently provides direct assistance for child-care expenses through a nonrefundable tax credit (CDCC), block grants to states (Child Care and Development Block Grant [CCDBG], and Temporary Assistance to Needy Families [TANF]), and flexible spending accounts. Indirect support for child-related expenses is provided through the nonrefundable Child Tax Credit (CTC), and the partially refundable Additional Child Tax Credit (ACTC).<sup>4</sup> After briefly summarizing current programs, I offer a new approach for funding child care that could boost employment and subsidize families to secure quality center-based care.

TABLE 10-1.

**Out-of-Pocket Child-Care Costs, Earnings, and Income of Families with Working Mothers**

|  | Single, child under age 5 | Single, child under age 13 | Married, child under age 5 | Married, child under age 13 |
|--|---------------------------|----------------------------|----------------------------|-----------------------------|
| Median out-of-pocket child-care costs                                      | \$3,000                   | \$2,600                    | \$5,400                    | \$4,680                     |
| Median family earnings   | \$19,200                  | \$23,088                   | \$82,500                   | \$83,880                    |
| Median family income   | \$22,000                  | \$26,445                   | \$85,276                   | \$87,000                    |
| Median out-of-pocket child-care costs as percent of median family earnings | 15.6%                     | 11.3%                      | 6.5%                       | 5.6%                        |
| Interquartile range of out-of-pocket child-care costs                      | \$4,400                   | \$3,800                    | \$7,300                    | \$6,500                     |

Sources: U.S. Census Bureau various years; author's calculations.

Note: The interquartile range is the difference between the 75th percentile of out-of-pocket child-care costs and the 25th percentile of out-of-pocket child-care costs.

Data are derived from the Current Population Survey and are pooled across the 2012 and 2013 waves.

**CURRENT PROGRAMS**

***Child and Dependent Care Credit (CDCC)***

The CDCC, established in 1976, is the oldest of the U.S. tax code credits related to child care. This nonrefundable credit covers qualifying child-care expenses of working parents with children under the age of thirteen. The parent(s) must have earned income and/or net positive self-employment income. For married couples filing jointly, one spouse may be considered having earned income if he or she is a full-time student or disabled; the family may not claim child-care expenses in excess of the lower of the two spouses' earnings. The credit is worth 35 percent of qualifying expenses (capped at \$3,000 for one child and \$6,000 for two or more children) for families with adjusted gross income (AGI) under \$15,000. As such, the maximum credit is \$1,050 for one child and \$2,100 for two or more children. The credit rate is lowered by 1 percentage point for each \$2,000 of AGI above \$15,000 until it plateaus at a 20 percent rate for income above \$43,000. There is no income cap for eligibility, and because it is nonrefundable, the credit affects only filers with a positive pre-credit tax liability. Therefore, many EITC recipients do not qualify for the current CDCC. The Urban-Brookings Tax Policy Center estimated that in 2013 the largest average benefits of the CDCC accrued to families with annual incomes between \$100,000 and \$200,000 (Maag 2013).

***Child Care and Development Fund (CCDF) and Temporary Assistance to Needy Families (TANF)***

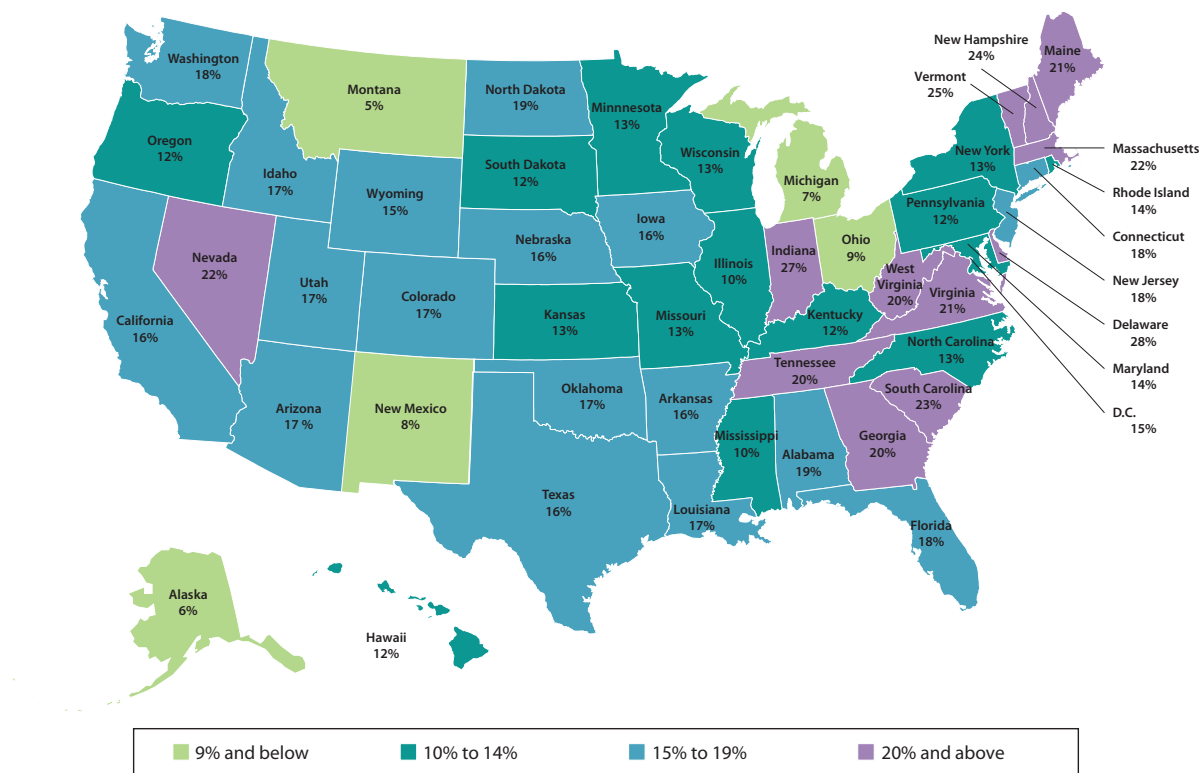
The 1996 welfare reform law expanded and consolidated the discretionary child-care funding in the CCDBG of 1990 with

mandatory child-care funding in Section 418 of the Social Security Act. The CCDF, formed by welfare reform, allocates funds to states to help low- and moderate-income families pay for child care, and also establishes state law and licensing for child care. In fiscal year (FY) 2012, about \$5.2 billion was allocated to CCDF: \$2.3 billion in discretionary CCDBG funds and \$2.9 billion in mandatory Section 418 funds (Congressional Research Service 2012).<sup>5</sup> In addition, states may transfer up to 30 percent of their TANF grant to CCDF, and may also directly spend TANF funds on child care. In FY2012, states transferred about \$1.36 billion to CCDF from TANF, and spent about \$1.23 billion directly out of TANF on child care. Moreover, states spent about \$2.4 billion of their own funds on child care, financed out of Maintenance of Effort requirements for TANF, and/or Separate State Program funds, bringing total federal and state spending in FY2012 to about \$10.2 billion (U.S. Department of Health and Human Services [DHHS] 2012).

To be eligible for CCDF assistance, children must be under age thirteen and living with parents who must be working, in school, or in protective services. Federal law limits eligibility to those families with incomes less than 85 percent of state median income. However, states have the option to impose lower limits, and in fact, in 2012 the median eligibility rate was substantially lower at 54 percent of state median income. Child-care assistance via CCDF and TANF is not an entitlement, and in FY2012 twenty-two states either had active waiting lists or had frozen intake (Schulman and Blank 2013). Estimates show that in FY2009 only one in six children

FIGURE 10-3.

## Ratio of Median Out-of-Pocket Child-Care Expenses to Median Earnings of Single Mothers, by State



Sources: U.S. Census Bureau various years; author's calculations.

Note: Data are derived from the Current Population Survey and are pooled across the 2012 and 2013 waves.

eligible for CCDF or TANF child care received assistance (DHHS 2013).

### Flexible Spending Accounts (FSAs)

FSAs allow workers to set aside a share of pretax income for designated purposes—including medical costs, transportation, and dependent care. Dependent care FSAs allow workers to set aside up to \$5,000 annually to pay qualified dependent care costs. Contributions to these accounts are not subject to income or payroll taxes. Married taxpayers must both be working to take advantage of the deduction. Eligible expenses for child care are subject to several limitations, such as the following: Child-care expenses are limited to those for dependent children younger than thirteen. Any given expense cannot be paid through FSA funds and be claimed for the CDCC. Unspent funds are forfeited at the end of the plan year.

### Child Tax Credit (CTC)

The CTC was established to partially offset the costs of raising a child as part of the Taxpayer Relief Act of 1997; as of FY2012, the CTC provided a credit worth up to \$1,000 per qualifying child under the age of seventeen. In general, the CTC is not refundable, but if earnings exceed \$3,000 or the family has three or more qualifying children, it is possible for the filer to qualify for the ACTC, which is refundable. If the value of the CTC exceeds federal tax liability, then a refund not to exceed 15 percent of earnings above the \$3,000 threshold can be received as the ACTC. The Urban-Brookings Tax Policy Center estimated that in 2013, 38 million families claimed credits totaling nearly \$60 billion, but only 13 percent of benefits went to the bottom income quintile; about 77 percent of benefits accrued to the middle quintiles, and 10 percent went to the top quintile (Maag and Carasso 2013). The CTC is phased out starting at earnings of \$110,000 for married couples filing jointly (\$75,000 for head

of household), and is eliminated at earnings above \$150,000. The lower threshold of \$3,000 expires after the 2017 tax year, when it will return to its pre-2001 tax reform level (over \$13,000 in 2013); thus, it will no longer offer assistance to families with very low incomes.

**PROPOSAL: A REFUNDABLE CHILD AND DEPENDENT CARE CREDIT**

Although the federal government is actively involved in the provision of child-care assistance, two of the programs are poorly targeted—the CDCC and CTC—and the one that is targeted to low-income families (CCDF) leaves an overwhelming majority of those eligible for care uncovered. In a marked difference, the EITC is very target efficient and is proven to be a highly successful prowork, antipoverty policy tool. A virtue of the EITC is that, as a cash refund to taxpayers, the taxpayer can spend the money flexibly to meet a host of needs. A case could also be made to supplement the EITC with a targeted assistance program like a child-care credit. Workers with dependent children use child care in tandem with labor-market work, and thus a child-care credit can improve the efficiency of the tax system by lowering some of the disincentives to work from high marginal tax rates (Currie and Gahvari 2008). A survey of the literature on the employment effects of subsidized care suggests that a 10 percent reduction in the price of child care will increase employment of single mothers by 3 to 4 percent and of married mothers by 5 to 6 percent (Ziliak, Hokayem, and Hardy 2008).

Another upside of a targeted child-care credit is that a directed credit ensures that the money is spent on child care. Many low-income working families have insufficient resources to invest in quality child care, and thus resort to lower-quality, but less-expensive, informal care, often relying on friends, family, and others. Research has shown that children in high-quality centers experience both short- and long-term benefits compared to children in informal care settings, ranging from better test scores in the short run to reduced grade retention rates, higher graduation rates, higher earnings, and reduced criminal activity in the long run (Bernal and Keane 2011; Blau and Currie 2006; Heckman, Stixrud, and Urzua 2006; Morris et al. 2009).

A reform that will spur employment among low-income parents, and also expand opportunities for families to place their children in quality, center-based care, is to convert the CDCC from a nonrefundable credit with no income limit to a refundable credit that is targeted to low-income working families. Building off current tax law, I propose the following changes to the CDCC (summarized in table 10-2):

- Convert to refundable credit
- Convert to child age-dependent credit rate

- Place income limit on credit
- Vary by type of child-care provider

For children under the age of five with family AGI of less than or equal to \$25,000, I propose a 100 percent refundable credit up to \$4,000 in qualifying expenses for the first child in a licensed facility, with a maximum allowable expense of \$6,000 for two or more children. The credit rate declines by 10 percentage points for each additional \$5,000 in AGI, and is phased out for AGI above \$70,000. For children between the ages of five and twelve, the rate is 70 percent for families with AGI below \$25,000, declines by 7 percentage points for each additional \$5,000 in AGI above \$25,000, and is zero for AGI above \$70,000. The base of qualifying expenses is the same. Like the current CDCC, the dollar amount of the credit applies to that portion of AGI received from earnings as defined in Form 2441.

In an effort to steer children to licensed, center-based child-care facilities, the credit rate is double that available to those families choosing unlicensed or informal care settings. Making the credit twice as valuable for licensed care is justified because of the high expense of this type of care, as well as the evidence pointing to the child-development benefits of center-based care (note, however, that not all licensed care is in a center). At the same time, allowing the refundable credit for those utilizing unlicensed care facilities acknowledges the fact that many low-income mothers work nonstandard shifts—nights and weekends—when formal care facilities are less readily available. The current Form 2441 used for the CDCC requires the filer to report the name, address, employer identification (or Social Security number), and amount paid for care. The refundable CDCC would also require this information; because licensing of centers is already a function carried out by states, a registry of licensed facilities could be linked to IRS records with this form to verify claims for the licensed- versus unlicensed-care credit amount.<sup>6</sup>

Because child care is generally paid weekly or monthly, and since many low-income families are liquidity constrained, receiving the credit in advance—the Advance CDCC (ACDCC)—should be made optional for claimants. Until 2010, taxpayers had the option of receiving the EITC throughout the year in their paychecks (Advance EITC). However, the experience with the Advance EITC is generally considered a failure because fewer than 3 percent of recipients opted for the advance payment, and those that did frequently made mistakes (Government Accountability Office 2007).

Research suggests that EITC recipients prefer to receive the credit as a lump sum, and want to avoid situations where they receive too large a credit during the year and then are forced

TABLE 10-2.

## Schedule for Refundable Child and Dependent Care Credit

|                                  | AGI ≤ \$25,000                    | \$25,000 < AGI ≤ \$70,000            | AGI > \$70,000 |
|----------------------------------|-----------------------------------|--------------------------------------|----------------|
| <b>Licensed facility rates</b>   |                                   |                                      |                |
| <b>Children under age 5</b>      |                                   |                                      |                |
| Credit rate                      | 100%                              | Reduced 10 pp for every \$5,000 AGI  | 0              |
| Credit base                      | \$4,000 first child; \$6,000 max. | \$4,000 first child; \$6,000 max.    | 0              |
| Refundable                       | Yes                               | Yes                                  | 0              |
| <b>Children ages 5 to 12</b>     |                                   |                                      |                |
| Credit rate                      | 70%                               | Reduced 7 pp for every \$5,000 AGI   | 0              |
| Credit base                      | \$4,000 first child; \$6,000 max. | \$4,000 first child; \$6,000 max.    | 0              |
| Refundable                       | Yes                               | Yes                                  | 0              |
| <b>Unlicensed facility rates</b> |                                   |                                      |                |
| <b>Children under age 5</b>      |                                   |                                      |                |
| Credit rate                      | 50%                               | Reduced 5 pp for every \$5,000 AGI   | 0              |
| Credit base                      | \$4,000 first child; \$6,000 max. | \$4,000 first child; \$6,000 max.    | 0              |
| Refundable                       | Yes                               | Yes                                  | 0              |
| <b>Children ages 5 to 12</b>     |                                   |                                      |                |
| Credit rate                      | 35%                               | Reduced 3.5 pp for every \$5,000 AGI | 0              |
| Credit base                      | \$4,000 first child; \$6,000 max. | \$4,000 first child; \$6,000 max.    | 0              |
| Refundable                       | Yes                               | Yes                                  | 0              |

Note: pp = percentage points.

to repay the IRS on April 15 (Romich and Weisner 2000). This makes sense when the mental accounting of the EITC is to apply it toward paying off debt or to make a down payment (Gao, Kaushal, and Waldfogel 2009; Smeeding, Ross Phillips, and O'Connor 2000). However, with regular child-care expenses, the ACDCC seems more likely to be used, and more akin to Supplemental Nutrition Assistance Program (SNAP) benefits—formerly known as the Food Stamp Program—that are received monthly.

The issue then is how to design the ACDCC with greater success than the Advance EITC. New Zealand, for example, direct deposits advance tax credits in the recipient's bank account each week (or every two weeks, or annually, depending on the recipient's pay period), and any overpayment is balanced by a subsequent payback schedule for the recipient. Generally,

the payback is not lump-sum unless the taxpayer does not report the overpayment until his or her submission of the end-of-year tax return. The United Kingdom offers something similar. A possible structure for the ACDCC, should the taxpayer elect to receive it, is to cap the advance portion at 50 percent of the total prior-year credit and to deposit it in equal monthly installments. At the time of tax filing the credit amount (under or overclaim) can be reconciled. Capping it at 50 percent should reduce the incidence of overclaiming, while also providing needed assistance throughout the year.

### COSTS AND BENEFITS

There are three primary benefits of a refundable CDCC. First, by offsetting the costs of child care, the reformed CDCC would encourage greater labor force participation by working parents. This higher labor supply would benefit affected

families and increase our nation's productive capacity. Second, the expanded credit would increase the disposable income of working families, leading to more resources and improved well-being for households with children. Third, subsidized child care would allow more working parents to move their children from informal care arrangements into higher-quality center-based care.

On the cost side, it is important to acknowledge that not all groups are held harmless by this proposal. Namely, families making greater than \$70,000 would lose eligibility for the CDCC, which will require those families to bear a slightly higher tax burden. Moreover, shifting the nonrefundable credit that currently benefits high-income families to a refundable credit that benefits low- and middle-income families could reduce labor effort among upper-middle-income families. Any such effect is likely to be minimal because the current maximum nonrefundable credit—\$600 for one child and \$1,200 for two or more children—represents a small share of income for high-income workers and, as such, is unlikely to be a decisive factor in their labor supply decisions.

An additional potential cost comes from the possibility that the phase-out range of the refundable CDCC will create additional disincentives to work. In particular, the phase-out tax rates of 10.0 percent and 7.5 percent depending on the age of the child (5.0 percent and 3.5 percent for unlicensed care) will overlap with the phase-out rates of the EITC (16.0 percent for one child and 21.1 percent for two or more children). Research by Eissa and Hoynes (2004) suggests that any reduced labor supply response will most likely come from the work decisions of married women—whether to work and how many hours—but the effects are modest. A recent proposal by Kearney and Turner (2013) to provide a secondary-earner tax deduction for earnings up to \$60,000, if enacted, is likely to mitigate any disincentive from the refundable CDCC among low- and middle-income married couples.

In terms of tax revenue cost to the government, because the proposed policy would couple the refundability of the credit with an income limit on eligibility, the lost tax revenue associated with this proposal is likely to be modest. Still, even considering that the expanded credit could lead to some tax revenue loss, the benefits of the proposed reform outweigh the costs. A sizable child-care subsidy for low- and middle-income working parents will increase the work efforts and the returns to work for low- and moderate-income families. It will make the U.S. tax code more progressive in a way that will likely have no discernible work disincentives for higher-earning individuals.

## Questions and Concerns

### *Why create a new refundable credit in lieu of expanding the CTC and/or EITC?*

A credit that can be used flexibly like the CTC and the EITC is generally favored by economists, and the refundable CDCC is more administratively burdensome because of the need to track expenses, and to track whether the provider is licensed. However, as discussed previously, the evidence suggests that the EITC is not spent directly on the child, and there is no evidence on how the CTC is spent. There is some limited evidence that the expanded generosity of the EITC could lead to improvements in children's math and reading achievement, but the mechanisms are as yet unknown (Dahl and Lochner 2012). If a key goal is to focus policy on boosting employment and early childhood development, then a targeted child-care credit makes sense, and in fact, would be more target efficient in achieving those dual goals than expanding the CTC or EITC. Moreover, while the proposed credit is dedicated to child care only, it maintains a high degree of consumer sovereignty akin to the EITC in that the credit can be received across a host of providers—public, private, licensed, and unlicensed.

### *Why not expand the CCDF and run all child-care assistance through block grants?*

The CCDF provides assistance to TANF and other low-income families, and should be used as a first line of child care for these families. However, the reach of this program is very low. As noted, in 2009 only one of six eligible children was reached by CCDF and TANF child-care programs. On the contrary, recent estimates place take-up rates in each of the EITC and SNAP programs at 79 percent (IRS 2014; U.S. Department of Agriculture 2014). Because the refundable CDCC is a blend of the latter two programs, it is expected that take-up rates will be much higher than CCDF/TANF child care.

### *Does creating a wedge in the credit's generosity between licensed and unlicensed care facilities raise the prospects of fraudulent claims?*

The concern is that taxpayers may falsely claim that the provider is licensed, or may not know whether the provider is licensed, and claim the higher credit amount when they are only eligible for the lower amount. Estimates in 2011 showed that just over 60 percent of children under age five had a regular child-care arrangement, and of those, 25 percent were in an organized care facility and over 40 percent received care from a relative, most often a grandparent (Laughlin 2013). This suggests that there will be opportunities to game the system. A way to mitigate such false claims is to not distinguish licensed from unlicensed facilities, and to offer only a single credit



schedule. However, this does not seem desirable because the benefits of quality, center-based care are well established and the proposed credit is designed to incentivize the use of center-based care. Moreover, as noted, states already have a process of licensing care facilities, and the IRS can utilize this system to verify claims. One option would be to require child-care providers to file a Form 1098 documenting the dollar amount of child-care payments received from the taxpayer. This is akin to what a bank does for mortgage interest payments received, or an educational institution for tuition payments received, with the presumption that dual filing by both the payer and recipient will reduce the incidence of false claims.

## Conclusion

The proposed refundable CDCC is highly progressive, redirecting current tax expenditures of the CDCC from the top two income quintiles to the bottom two quintiles. As such, this proposal directly addresses the issue of widening inequality, creating opportunity for upward mobility in the bottom half of the distribution by making work more attractive. Importantly, unlike the current CDCC available only to those with positive tax liability, this new credit is more of a complement to the existing EITC; the two can be received in tandem as refundable credits. Moreover, making the credit

rate age-dependent and more valuable for placements in center-based care recognizes the fact that the cost of center-based care is much higher for young children, and potential long-term benefits of making center-based care affordable for low-income parents is backed by evidence (Bernal and Keane 2011; Blau and Currie 2006; Morris et al. 2009). There is also increasing evidence that making the tax code more age-dependent brings us closer to an optimal tax structure (Bastani, Blomquist, and Micheletto 2013; Weinzierl 2011). This is based on the notion of tagging proposed long ago by Akerlof (1978), who showed that tax efficiency and redistribution can be improved if different tax schedules are applied to readily verifiable characteristics, which could include the age of the child as proposed here (Mankiw, Weinzierl, and Yagan 2009). While the size of the benefit is on par with, or larger than, the current EITC, there is precedent for such tax incentives in both the British and New Zealand tax codes, and in both of those countries the size of the child-care benefits are larger. Take-up of the credit, however, is likely to be lower than that of the EITC, especially among married families, as many will continue to keep one parent at home to raise children. The latter, coupled with the fact that families with incomes above \$70,000 will no longer be eligible for the CDCC, could easily leave this proposal revenue neutral or better.

---

**ACKNOWLEDGMENTS:** I thank Robert Paul Hartley for excellent research assistance. I am grateful for helpful suggestions on an earlier draft from Janet Currie, Bill Gale, Ben Harris, Melissa Kearney, Tim Smeeding, Ken Troske, Jane Waldfogel, and seminar participants at the authors' workshop at The Hamilton Project. All errors are my own.

## Author

### **James P. Ziliak**

*Gatton Endowed Chair in Microeconomics, Department of Economics, University of Kentucky; Director, Center for Poverty Research, University of Kentucky*

James P. Ziliak holds the Carol Martin Gatton Endowed Chair in Microeconomics in the Department of Economics and is founding director of the Center for Poverty Research at the University of Kentucky. He served as assistant and associate professor of economics at the University of Oregon, and has held visiting positions at the Brookings Institution, University College London, University of Michigan, and University of Wisconsin. He currently serves as chair of the board of overseers of the University of Michigan Panel Study of Income Dynamics. His research expertise is in the areas of labor economics, poverty, food insecurity, and tax and transfer policy. Recent projects include trends in earnings and income volatility in the United States, the origins of persistently poor regions in America, the causes and consequences of hunger among older Americans, and the effect of survey nonresponse on the level of and trends in poverty and inequality. He is editor of *Welfare Reform and its Long Term Consequences for America's Poor* and *Appalachian Legacy: Economic Opportunity after the War on Poverty*.

## Endnotes

1. Author's calculations using data from two-year averages of earnings by state in 2012 and 2013 Annual Social and Economic Study of the Current Population Survey (U.S. Census Bureau various years).
2. The CDCC and the CCDF require children under age thirteen to be present for eligibility, while the CTC extends eligibility to families with children under age seventeen. Employment trends are nearly identical for mothers including this wider age range of children.
3. Beginning with the 2011 wave, the Census Bureau has asked respondents the amount of out-of-pocket child-care costs they incur because of work. The numbers in table 10-1 and figure 10-3 pool the 2012 and 2013 survey years in order to reduce the influence of outliers in smaller states (U.S. Census Bureau various years).
4. The tax code also subsidizes child care through the employer-provided child-care exclusion, which permits employers to exclude up to \$5,000 from an employee's salary on a pretax basis. There are other programs that assist with early childhood development, such as Head Start, that are beyond the scope of this paper.
5. Discretionary CCDBG grants are allocated to states based on a formula that accounts for the state's share of children under age five, the state's share of children receiving free or reduced price lunch, and the state's per capita income. Part of the mandatory CCDF funds are allocated based on the state's funding for child-care programs authorized under the Aid to Families with Dependent Children program in fiscal years 1994 and 1995, and part based on the state's share of children under age thirteen (Congressional Research Service 2012). Since 1996 the basic TANF block grant to states totaled \$16.5 billion, which had declined by about one-third in inflation-adjusted terms by FY2012 (Congressional Research Service 2013). The state's share of the block grant is a function of its average expenditure on Aid to Families with Dependent Children during FY1992-FY1994.
6. See <https://daycare.com/states.html> for links to each state's licensing requirements.

## References

- Akerlof, George. 1978. "The Economics of 'Tagging' as Applied to the Optimal Income Tax, Welfare Programs, and Manpower Planning." *American Economic Review* 68 (1): 8–19.
- Bastani, Spencer, Soren Blomquist, and Luca Micheletto. 2013. "The Welfare Gains of Age-Related Optimal Income Taxation." *International Economic Review* 54 (4): 1219–49.
- Baum II, Charles. 2002. "A Dynamic Analysis of the Effect of Child Care Costs on the Work Decisions of Low-Income Mothers with Infants." *Demography* 39: 139–64.
- Berger, Mark, and Dan Black. 1992. "Child Care Subsidies, Quality of Care, and the Labor Supply of Low-Income, Single Mothers." *The Review of Economics and Statistics* 74: 635–42.
- Bernal, Raquel, and Michael P. Keane. 2011. "Child Care Choices and Children's Cognitive Achievement: The Case of Single Mothers." *Journal of Labor Economics* 29 (3): 459–512.
- Blank, Rebecca, and Brian Kovak. 2008. "Helping Disconnected Single Mothers." Center on Children and Families Brief #38, The Brookings Institution, Washington, DC.
- Blau, David, and Janet Currie. 2006. "Preschool, Day Care and After-School Care: Who's Minding the Kids." In *Handbook of Economics of Education*, edited by Eric Hanushek and Finis Welch, 1163–1278. New York: North Holland.
- Bollinger, Christopher, Luis Gonzalez, and James P. Ziliak. 2009. "Welfare Reform and the Level and Composition of Income." In *Welfare Reform and its Long-Term Consequences for America's Poor*, edited by James P. Ziliak, 59–103. Cambridge: Cambridge University Press.
- Child Care Aware of America. 2013. *Child Care in America: 2013 State Fact Sheets*. Child Care Aware of America, Arlington, VA.
- Congressional Research Service. 2012. "The Child Care and Development Block Grant: Background and Funding." RL30785, by Karen Lynch.
- Congressional Research Service. 2013. "The Temporary Assistance for Needy Families (TANF) Block Grant: A Primer on TANF Financing and Federal Requirements." RL32748, by Gene Falk.
- Currie, Janet, and Firouz Gahvari. 2008. "Transfers in Cash and In-Kind: Theory Meets the Data." *Journal of Economic Literature* 46 (2): 333–83.
- Dahl, Gordon, and Lance Lochner. 2012. "The Impact of Family Income on Child Achievement: Evidence from the Earned Income Tax Credit." *American Economic Review* 102 (5): 1927–56.
- Eissa, Nada, and Hilary Hoynes. 2004. "Taxes and the Labor Market Participation of Married Couples: The Earned Income Tax Credit." *Journal of Public Economics* 88 (9–10): 1931–58.
- Fox, Liana, Wen-Jui Han, Christopher Ruhm, and Jane Waldfogel. 2013. "Time for Children? Trends in the Employment Patterns of Parents, 1967–2009." *Demography* 50 (1): 25–49.
- Gao, Qin, Neeraj Kaushal, and Jane Waldfogel. 2009. "How Have Expansions in the Earned Income Tax Credit Affected Family Expenditures?" In *Welfare Reform and its Long-Term Consequences for America's Poor*, edited by James P. Ziliak, 104–171. Cambridge: Cambridge University Press.
- Government Accountability Office (GAO). 2007, August. "Advanced Earned Income Tax Credit." Report to the Joint Committee on Taxation. <http://www.gao.gov/assets/270/265295.pdf>.
- Grogger, Jeffrey. 2003. "The Effects of Time Limits, the EITC, and Other Policy Changes on Welfare Use, Work, and Income Among Female-Headed Families." *Review of Economics and Statistics* 85 (2): 394–408.
- Heckman, James, Jora Stixrud, and Sergio Urzua. 2006. "The Effects of Cognitive and Noncognitive Abilities on Labor Market Outcomes and Social Behavior." *Journal of Labor Economics* 24 (3): 411–82.
- IRS. 2014. "EITC Participation Rate by States." IRS, Washington, DC. <http://www.etc.irs.gov/EITC-Central/Participation-Rate>.
- Kearney, Melissa, and Lesley Turner. 2013. "Giving Secondary Earners a Tax Break: A Proposal to Help Low- and Middle-Income Families." Discussion Paper 2013-07, The Hamilton Project, Brookings Institution, Washington, DC.
- Kimmel, Jean. 1995. "The Effectiveness of Child-Care Subsidies in Encouraging the Welfare-To-Work Transition of Low-Income Single Mothers." *American Economic Review* 85: 271–75.
- Laughlin, Lynda. 2013. *Who's Minding the Kids? Child Care Arrangements: Spring 2011*. U.S. Census Bureau, 70–135. <http://www.census.gov/prod/2013pubs/p70-135.pdf>.
- Maag, Elaine. 2013. "Taxation and the Family: How Does the Tax System Subsidize Child Care Expenses?" Urban-Brookings Tax Policy Center, Washington, DC.
- Maag, Elaine, and Adam Carasso. 2013. "Taxation and the Family: What is the Child Tax Credit?" Urban-Brookings Tax Policy Center, Washington, DC.
- Mankiw, N. Gregory, Matthew Weinzierl, and Danny Yagan. 2009. "Optimal Taxation in Theory and Practice." *Journal of Economic Perspectives* 23 (4): 147–74.
- Meyer, Bruce, and Dan Rosenbaum. 2001. "Welfare, the Earned Income Tax Credit, and the Labor Supply of Single Mothers." *Quarterly Journal of Economics* 116 (3): 1063–1114.
- Morris, Pamela, Lisa Gennetian, Greg Duncan, and Aletha Huston. 2009. "How Welfare Policies Affect Child and Adolescent School Performance: Investigating Pathways of Influence with Experimental Data." In *Welfare Reform and its Long-Term Consequences for America's Poor*, edited by James P. Ziliak, 255–89. Cambridge: Cambridge University Press.
- Romich, Jennifer, and Thomas Weisner. 2000. "How Families View and Use the EITC: Advance Payment versus Lump Sum Delivery." *National Tax Journal* 53 (4): 1245–65.
- Schulman, Karen, and Helen Blank. 2013. "Pivot Point: State Child Care Assistance Policies 2013." National Women's Law Center, Washington, DC.

- Smeeding, Timothy, Katherin Ross Phillips, and Michael O'Connor. 2000. "The EITC: Expectation, Knowledge, Use, and Economic and Social Mobility." *National Tax Journal* 53 (4): 1187–1209.
- Tekin, Erdal. 2007. "Child Care Subsidies, Wages, and the Employment of Single Mothers." *Journal of Human Resources* 42: 453–87.
- U.S. Census Bureau. Various years. "Current Population Survey." U.S. Census Bureau, Washington, DC. [www.census.gov/cps](http://www.census.gov/cps).
- U.S. Department of Agriculture. 2014. "Supplemental Nutrition Assistance Program Participation Rates: Fiscal Years 2010 and 2011." Office of Policy Support, Food and Nutrition Service, U.S. Department of Agriculture, Washington, DC.
- U.S. Department of Health and Human Services (DHHS). 2012. "TANF Financial Data FY2012." Office of Family Assistance, Office of the Administration for Children and Families, U.S. Department of Health and Human Services, Washington, DC.
- . 2013. "Temporary Assistance for Needy Families: Tenth Report to Congress." Office of Family Assistance, Office of the Administration for Children and Families, U.S. Department of Health and Human Services, Washington, DC.
- Weinzierl, Matthew. 2011. "The Surprising Power of Age-Dependent Taxes." *Review of Economic Studies* 78 (4): 1490–1518.
- Ziliak, James P., Charles Hokayem, and Bradley Hardy. 2008. "Child Care Subsidies and the Economic Well-Being of Recipient Families: A Survey and Implications for Kentucky." Technical Report Prepared for the Kentucky Youth Advocates. University of Kentucky Center for Poverty Research, Lexington, KY.