



The Child and Dependent Care Tax Credit (CDCTC): Temporary Expansion for 2021 Under the American Rescue Plan Act of 2021 (ARPA; P.L. 117-2)

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The child and dependent care tax credit (CDCTC) can help to partially offset working families' child care expenses. The American Rescue Plan Act (P.L. 117-2; ARPA) provided a temporary expansion of the CDCTC for 2021. This Insight summarizes the temporary change, highlighting the credit amount for 2021 before and after the temporary expansion.

Beyond the CDCTC, working families may also be eligible to receive tax-free employer-sponsored child care benefits, often in the form of a flexible spending arrangement/account (FSA). ARPA increased the maximum amount of tax-free child care benefits employers could provide from **\$5,000 to \$10,500 for 2021**. This change is not discussed further in this Insight.

How would the CDCTC have been calculated for 2021 before ARPA?

For 2021, prior to ARPA, the CDCTC would have allowed eligible taxpayers to reduce their federal income tax liability, generally by up to \$600 if they had one **qualifying individual** or \$1,200 if they had two or more qualifying individuals, based on their child or dependent care expenses (hereinafter referred to for brevity as *child care expenses*). **Qualifying expenses** include expenses for the care of **a child under 13 years old or other dependent who is not able to care for themselves (i.e., "a qualifying individual")** that are incurred so the taxpayer can work (or look for work). Prior to ARPA, the 2021 CDCTC was nonrefundable, meaning that the amount of the credit was limited by the taxpayer's income tax liability. Taxpayers with little or no income tax liability, including many lower-income taxpayers, thus received little or no benefit from this credit.

The amount of the CDCTC for a given taxpayer is calculated by multiplying the amount of qualifying expenses, which are subject to a cap, by the appropriate credit rate. Absent the ARPA modifications, expenses were capped at \$3,000 for one qualifying individual and \$6,000 for two or more qualifying individuals (these levels were not annually adjusted for inflation). The credit rate varied based on the

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taxpayer's adjusted gross income (AGI). The credit rate was set at a maximum of 35% for taxpayers with AGI under \$15,000 (lower-income taxpayers could not benefit from this higher rate due to the fact that the credit was nonrefundable). The credit rate declined by one percentage point for each \$2,000 (or fraction thereof) above \$15,000 of AGI, until the credit rate reached its statutory minimum of 20% for taxpayers with AGI over \$43,000.

Since the ARPA changes are temporary, the CDCTC parameters will revert to their pre-ARPA permanent-law levels after 2021. CDCTC dollar amounts are not annually adjusted for inflation and do not vary by filing status.

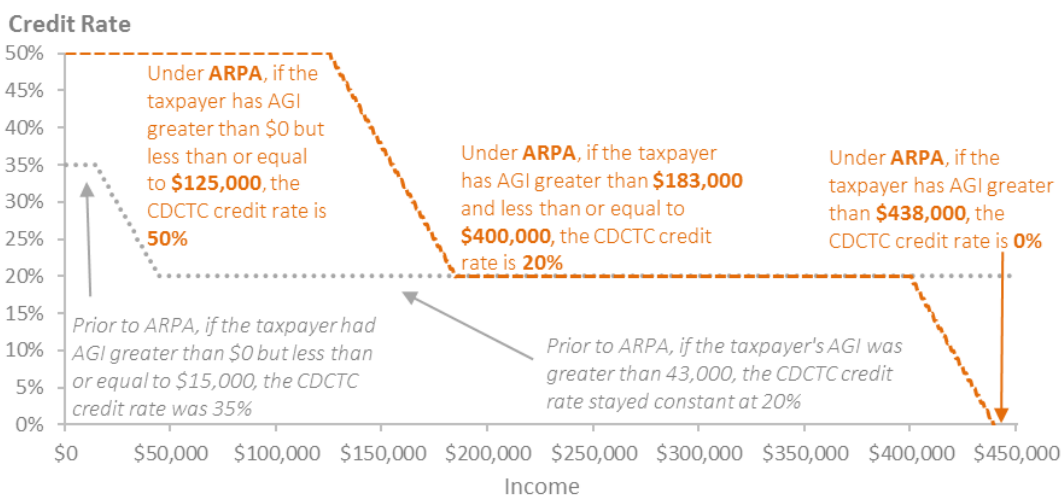
How did ARPA change the CDCTC for 2021?

ARPA made three major changes to the CDCTC:

- 1. Refundable:** The credit was made refundable for 2021, meaning the amount of the credit is no longer limited by a taxpayer's income tax liability.
- 2. Higher Cap on Expenses:** The amount of expenses used to calculate the 2021 credit was increased
 - from \$3,000 to \$8,000, if a taxpayer has one qualifying individual; and
 - from \$6,000 to \$16,000, if a taxpayer has two or more qualifying individuals.
- 3. Higher credit rate:** The 2021 credit rate increased for many low- and moderate-income taxpayers, and declined for the highest-income taxpayers, as illustrated below.

Child and Dependent Care Tax Credit (CDCTC) Credit Rate for 2021

Taxpayer with Two or More Qualifying Individuals and Maximum Amount of Employment-Related Child and Dependent Care Expenses



Specifically, the CDCTC credit rate for 2021 is

- For workers with income under \$125,000: 50%.
- For workers with income between \$125,000 and \$183,000: The credit rate gradually declines by one percentage point for each \$2,000 (or fraction thereof) above \$125,000 of AGI until it reaches 20% at \$183,000 of AGI.

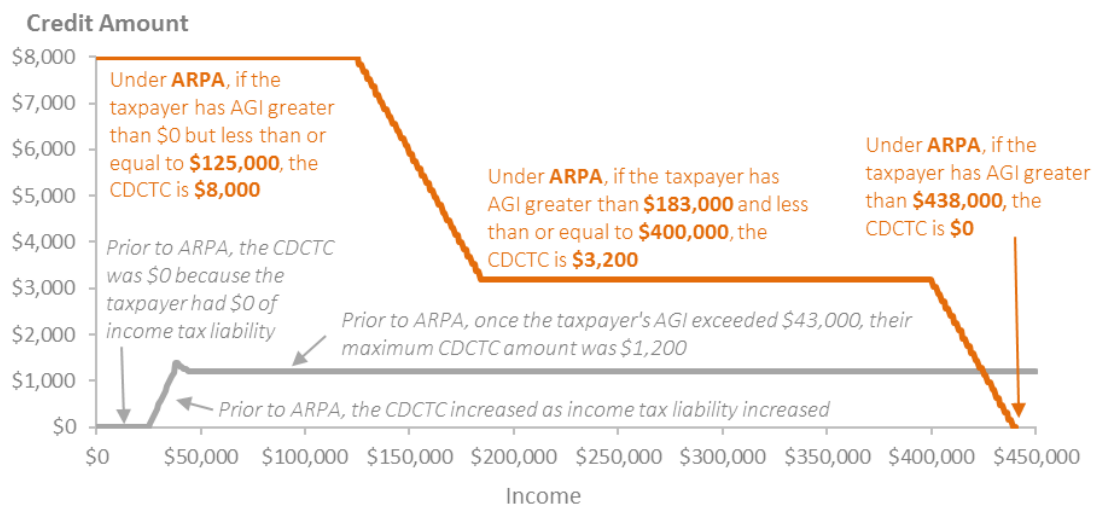
- For workers with income between \$185,000 and \$400,000: 20%.
- For workers with income over \$400,000: The credit rate gradually declines by one percentage point for each \$2,000 (or fraction thereof) above \$400,000 of AGI until it equals 0% at \$438,000 of AGI.

These dollar amounts are the same for all tax filing statuses. ARPA did not change the definition of qualifying expenses or qualifying individual.

The ARPA changes combined—the refundability, higher level of maximum expenses, and increase in the credit rate—will result in significantly larger credit amounts for many taxpayers, with actual changes in the credit amount depending on qualifying child care expenses and AGI, as illustrated below.

Child and Dependent Care Tax Credit (CDCTC) Amount for 2021

Taxpayer with Two or More Qualifying Individuals and Maximum Amount of Employment-Related Child and Dependent Care Expenses



Source: CRS calculations based on IRC §21 and P.L. 117-2.

Notes: Income is adjusted gross income. Taxpayer is assumed to claim the standard deduction and no other tax benefits.

What are some policy consideration with this expansion?

Insofar as Congress modifies, extends, or allows the 2021 changes to expire as scheduled, there may be several policy issues to consider.

First, the expanded credit may not provide the same benefit to lowest-income taxpayers as it does to moderate- and higher-income taxpayers, because the lowest-income taxpayers may have relatively little or no *qualifying expenses*. [Prior CRS analysis](#) indicates that lowest-income families tend to have child care expenses below the maximum level. Lower out-of-pocket child care expenses do not necessarily mean that lower-income populations do not have child care needs; rather, they may indicate that these needs are met informally—such as having a neighbor or relative watch a child during the workday. These informal arrangements may not result in formal out-of-pocket child care payments.

Second, the CDCTC (even after the ARPA expansion) is received as a lump sum payment. A once-a-year tax credit may, even when refundable, be of limited value to cash-strapped lower-income families. These families would still have to spend out of pocket, on an ongoing basis, what could be a relatively large share of their incomes in order to qualify for the CDCTC.

Third, to administer the CDCTC, the Internal Revenue Service (IRS) requires submission of a tax identification number for the provider of care (unless the taxpayer can show that they exercised due diligence in attempting to provide the required information). A taxpayer must include this information on the tax return to claim the credit. Given how much larger the CDCTC may be for some taxpayers, there may be concern about improper claims. Verification of qualifying expenses—for example, by requiring child care providers to submit an information return to both the IRS and the taxpayer that includes the qualifying individual’s name and taxpayer ID as well as the amount of qualifying expenses—may reduce improper claims, but increase taxpayer (and provider) burden.

Finally, an extension of the ARPA expansion to the CDCTC would reduce federal income tax revenue. The estimated cost of the one-year ARPA expansion is **\$8 billion**. Enacted in isolation, this would increase the budget deficit. These revenue losses could be offset by increased revenue elsewhere in the tax system, or by reduced spending.

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