Reducing Child Care Costs

Finding quality child care can be expensive. This guide provides information about various programs that can reduce the overall cost of child care for qualifying parents and guardians.

Dependent Care Assistance Plans (DCAP)

Many employers offer benefit packages that include flexible benefit or flexible spending plans. These plans allow working parents to deduct money from their paychecks, on a pre-tax basis, based on the amount they expect to pay for child care expenses during the year. By doing so, working parents can increase their "take-home" income and increase their child care "buying power" since federal, state and Social Security taxes are not paid on the amount of money set aside. Most plans allow a maximum of $5,000 to be set aside per year ($2,500 for those who are married and filing separately). The exact amount that can be set aside on a pre-tax basis will depend on the specifics of the employer's plan.

Eligible expenses may include:

- Cost of in-home care for children under age 13
- Cost of child care outside the home for children under age 13
- Cost of a child care center if it complies with all state and local laws, provides care for more than six children, and is paid for the services it provides
- Cost of a nursery school or daytime summer program for children, including lunches and enrichment programs

Donna and Steve were apprehensive about enrolling their one-year-old daughter, Alisa, at a child care center a few miles from their home. This would be Alisa's first time away from her mother for any length of time, but Donna was anxious to get back to work and the family needed her income. Donna commented, "Steve and I did our homework and researched all of the child care options in our area, but we're nervous about how much of our take-home pay will have to be budgeted to cover all of the expenses for Alisa's care. We want to make sure we've considered everything to get the best care for the most reasonable cost."

Ineligible expenses may include:

- Cost for care provided by a minor you claim as a dependent
- Cost for dependent care when your spouse is not working
- Cost for dependent care that enables your spouse to perform volunteer work
- Transportation expenses
- Educational expenses for the first grade and above
- Overnight camp expenses

Dependent care spending accounts are a "use it or lose it" benefit. If you do not spend all the pre-tax money you set aside within the current tax year, you will, unfortunately, forfeit the unused amount at year's end. Try to accurately predict how much you plan to spend for child care in a given year so that your pre-tax contribution comes close to matching that amount. Remember also, to plan ahead when paying child care bills since reimbursement time varies. Be advised that participation in your employer's dependent care assistance plan reduces the amount, possibly to zero, that you may take as a dependent care tax credit. Depending upon your tax bracket, you may be able to save more money in taxes by using your employer's plan than by taking the credit on your tax return. The only way to be sure is to calculate your savings using both methods and compare the results. Consult with your tax advisor if you are still unsure which option is best for you. If your employer offers a flexible spending plan, your benefits department should have more information about it.

The Child and Dependent Care Credit (CDCC)

Most working parents can claim a federal tax credit on their annual return to help reduce the cost of child care. A tax credit is the amount you may subtract from what you owe on your federal income tax return. This credit is often more beneficial than a tax deduction since a credit is treated as a dollar-for-dollar reduction in taxes owed, while a tax deduction merely reduces the base on which your tax is assessed. The Child and Dependent Care Credit (CDCC) is a tax benefit that may help you pay for the child care you need in order to work.

In order to claim the CDCC, you need to meet these requirements:

- You paid for child care for a child under the age of 13;
- You needed the child care to enable you to work or look for work. In a two-parent family, both parents must have needed child care to keep or get their current jobs—unless one parent is a full-time student or unable to care for him or herself;
- You (and your spouse if you are married) must have earned income during the year;
- The person for whom you are claiming the credit must have lived with you for more than half the year;
- Your filing status must be single, married filing jointly, head of household or widow(er) with a dependent or dependent child;
- You must identify the care provider on your tax return;
- You paid over half the cost of "maintaining your home," which means rent, food, etc.; and
- The amount of money you paid for child care was less than your annual earnings. If you are married, generally you must file a joint tax return, and your child care expenses must be less than the income made by the spouse with the lower earnings.

There are special rules for calculating the income of a spouse who was a full-time student or disabled. There are also rules on whether divorced or separated parents can claim the CDCC for child care. For information on these rules, call the IRS at 800-TAX-FORM (800-829-3676) and request publication #503, *Child and Dependent Care Expenses*, or visit its web site at www.irs.gov.

Virtually any kind of child care qualifies for the CDCC, including care provided by a child care center, a family child care home, a church or synagogue, or even a neighbor, friend or relative. However, child care provided by a spouse, a dependent, or your (or your spouse's) child under age 19 (even if not a dependent) does not qualify. The amount of money you receive through the CDCC depends on three things:

- The number of children for whom you paid child care costs;
- Your family income; and
- The amount you paid for child care during the year

Your family must file a federal income tax return to claim the credit. If you use Form 1040A to file your return, you must also complete and attach Schedule 2. If you use Form 1040 to file your return, you must complete and attach Form 2441. Both Schedule 2 and Form 2441 require you to report the caregiver's name, address, Social Security or tax ID number, and the amount you paid him or her for your child's care. To obtain this information, have your provider complete Form W-10. These forms are available from the IRS at no cost.

The credit you receive on your federal taxes through the CDCC will be between 20 and 35 percent of your eligible child care expenses, depending on your income and the number of children for whom you paid child care costs. The chart on Form 2441 will help you calculate what percentage of your child care expenses you can claim as a credit. (*Note*—The higher your income, the smaller the percentage.) There are some limitations on the amount of credit you can claim. If you received dependent care benefits from your employer, other rules apply.

Both the IRS and the National Women's Law Center can provide you with additional information on the CDCC as well as other state-level child and dependent care tax provisions. Call 202-588-5180 or visit www.nwlc.org for more information.

The Earned Income Tax Credit (EITC)

The earned income tax credit (EITC), also known as the Earned Income Credit (EIC), is a tax refundable credit for low- or moderate-income workers. The EIC seeks to reduce the tax burden on these workers and to supplement wages. In doing so, the EIC attempts to make child care costs more affordable. If you qualify for the EIC and file a federal tax return, you can get back some or all of the federal income tax that was taken out of your pay during the year. You may also get extra cash back from the IRS. Even if you have no federal income tax liability, you are still eligible to receive the EIC.

Single or married people who worked full time or part time during the filing year may qualify for the EIC depending on their income. The earned income requirements change yearly, so contact the IRS for the actual amounts or ask for publication #596, *Earned Income Credit*.

In addition to having met the income requirements, the child for whom you are claiming the EIC must have a valid Social Security number and meet the following tests:

- **Relationship test—**The child must be your son, daughter, adopted child, stepchild, eligible foster child or descendant of any of them (e.g., grandchild). Brothers, sisters, stepbrothers, stepsisters (or their descendants (e.g., a niece or nephew) also qualify.
- **Residency test—**The child must have lived with you in your main house in the United States for more than half of the year.
- **Age test—**The child must be under age 19 (or under 24 if a full-time student), or any age if permanently and totally disabled.

Only one person can treat a qualifying child as a qualifying child and claim the EIC for that child. If more than one person can claim a child as a qualifying child, they can determine between themselves who will claim the child. That person will claim the EIC, as well as any other applicable tax benefits since, generally, these tax benefits cannot be split between persons.

You can obtain the EIC through your federal income tax return. If you worked and had qualifying children, you must file either Form 1040 or 1040A and attach Schedule EIC. If you are married, you must file a joint return to get the EIC. You must provide a correct name and Social Security number for each person listed on your tax return and Schedule EIC. Missing or incorrect information will delay your refund. You do not have to calculate your own EIC; simply enter "EIC" next to the appropriate line on your federal tax return, attach Schedule EIC and the IRS will do it for you. Typically, this credit is provided in the form of a refund; if the credit exceeds your tax liability or if you do not owe any taxes, the IRS will issue a check for the amount of the EIC.

Instead of filing for the EIC through your federal income tax return, your employer can add a part of your EIC to each paycheck throughout the year. You would receive the balance of your EIC after you file your yearly tax return. This is called an "advance EIC payment." IRS Form W-5 will help you arrange for advance EIC payment. For many people, getting a part of their EIC in each paycheck can make a real difference in meeting day-to-day needs, such as the cost of child care.

In most cases, the EIC does not affect eligibility for benefits like Aid to Families With Dependent Children (AFDC), Medicaid, Food Stamps, Supplemental Security Income (SSI), or public or subsidized housing. In addition, families may receive both the EIC and the CDCC (described previously). Getting one of these credits does not affect a family's eligibility for the other in any way. Claiming both credits may mean even more money back from the IRS. If you are a legal immigrant, have a job and are classified as a "resident alien" for tax purposes, you are eligible for the EIC. Generally speaking, you must be a U.S. citizen or resident alien for the entire year for which you are filing for the EIC. If you (or your spouse, if married) were a nonresident alien for any part of the year, you cannot claim the earned income credit unless your filing status is married filing jointly.

For information about how you can get the EIC, appropriate tax forms, and free help filing your taxes, call the IRS at 800-829-1040. You will be put in touch with a local Volunteer Income Tax Assistance (VITA) center. VITA volunteers are trained by the IRS to answer any questions and help you fill out forms.

Public Subsidies and Scholarships

Under the Welfare Reform Act, the state and federal governments offer subsidized child care programs for newly employed parents no longer on public assistance or parents in job-related training/education. Since each program and its administrating body differ from state to state, call your state's Social Services agency to find out who to call about public subsidies.

Economically disadvantaged preschool-aged children as well as children with state-recognized special needs are eligible for health, educational, nutritional and social services through the Head Start Program. Parents need to meet certain financial qualifications to be eligible.

Families with financial need may qualify for scholarships from various community-based programs such as the United Way, YWCA, YMCA and the Salvation Army. Parents are sometimes given discounts if they have more than one child enrolled in the same program. Providers may also offer a discount in exchange for volunteer work or other services. Contact the program director to discuss co-op job opportunities.

Other Money-Saving Tips

- **Combine community resources with family help—**Consider enrolling your child in a care facility part time and having friends or family provide care the rest of the time (i.e., three days at a center and two days under the care of a grandparent).
- **Subsidized care—**Some child care facilities are supported by organizations so enrollment fees are considerably lower. For example, a for-profit organization such as a corporation may subsidize child care costs for its employees, or a not-for-profit organization such as a YMCA may subsidize costs for members whose children attend day care at the YMCA.
- **Shared care—**You could split the cost of full-time care with another parent and have your children share the care "slot" by each attending part time.
- **Sibling discounts—**If you have more than one child who requires child care, consider enrolling both in a program that offers discounts for siblings. This can make a big difference.
- **Sliding fee schedule—**Parents in lower income brackets may want to consider a care arrangement that adjusts the cost of care according to the family's income.

When Changes In Your Financial Situation Affect Your Care Arrangement

Child care can be an expensive proposition for any budget. If your financial situation changes for the worse, you may have to re-evaluate your child care expenditures. Below are some things to consider.

- Is there a less expensive child care alternative available? A family child care home might cost less than a child care center. If you have several children, an in-home caregiver may be more affordable. Or perhaps a relative, neighbor or friend can care for your child for significantly less. Another alternative is to combine a formal program with less expensive part-time care provided by a friend or relative.
- Can you afford child care at all? If you live in a dual-income household, a lower combined annual income may negate the sense of two incomes when compared to the cost of child care. To examine the economics of dual careers, calculate your annual child care expenses. Compare this total to each parent's salary. If child care costs are more than or equal to one parent's salary, it may be more cost-effective for that parent to care for the child full time.
- Can one parent take on the caregiving role temporarily? If you or your spouse is suddenly without a job, perhaps that person can take on some or all of the caregiving role while seeking employment.
- Is moving to an area with a lower cost of living an option?
- Can you apply for a scholarship? Your child's current child care facility may offer a scholarship program.
- Are you eligible for the CDCC and the EIC? Have you taken advantage of the CDCC and/or the EIC?
- Is there a flexible spending account available through your employer, and are you taking advantage of it?
- Are there other ways to get financial aid? Are you eligible for any child care public subsidies? Is a loan a possibility, or can you borrow against or withdraw from your retirement savings?
- Are there other ways to cut costs? Can you cut expenditures in other areas enough to justify keeping your current child care arrangement?

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