DEPARTMENT OF HEALTH AND HUMAN SERVICES

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Number of Pages + Cover 2

REMARKS Jen - 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)

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

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.

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.

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

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.

Prepared by Office of Economic Policy, Treasury Department and the Council of Economic Advisers; August 19, 1997.

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
Michalop-oulos 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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REMARKS:

SECOND-TIER TAX ISSUES OF INTEREST TO EXECUTIVE BRANCH DEPARTMENTS

++ LABOR - HHS

- **Credit for 50% of child care expenditures of employers, maximum credit value is $150,000; sunset 12/31/99 (Senate Bill VII.50)**

Under current law an employer who has an existing child care facility would take a business expense deduction for the operating costs. This proposal would allow employers a 50% credit for money to acquire, construct or rehabilitate their child care facility or to operate their own child care facility. The maximum credit available in a single year would be $150,000. The credit would be claimed as part of the general business credit. The credit would be available for years beginning after December 31, 1997 and not for taxable years beginning after December 31, 1999.

> Recommended Position: Do not support. While we are sympathetic to the goal of expanding the number of placements available in licensed, accredited day care facilities, this proposal may result in substantial revenue loss without contributing significantly to accomplishing that goal. We are concerned that the credit would simply allow taxpayers to take an enhanced tax benefit for expenses they already incur. This provision would allow the taxpayer to turn the deduction into a much more valuable credit without expanding the number of children receiving care. It may also result in unfair treatment to child care centers operated out of people's homes, which is a crucial source of support and employment for people moving from welfare to work. The cure to this problem would result in additional complexity.

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 per week.

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.

  - Move the phaseout range of the CDCTC credit to $18,000 to $47,000.

  - Use the same phaseout range for the credit as above, but raise the top credit to 50 percent (and phaseout to 20 percent).

  - 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.

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
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
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

August 27, 1997

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

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

Department of the Treasury
Office of Tax Analysis

September 23, 1997
v. 12adj

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.

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).

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:
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 the totals. Deciles derived from income distribution of 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.

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 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).

PRELIMINARY
Distribution of Employer Provided
Dependent Care Benefits
1995

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

Bruce, Jen, Nicole, Neera -
looks like an
interesting idea.
Elena

December 13, 1997

MEMORANDUM FOR GENE SPERLING

FROM: JON ORSZAG

SUBJECT: Low-Income Housing Tax Credit and Child Care

I have attached a letter from Bobby Rozen explaining a technical change in the Low-Income Housing Tax Credit (LIHTC) that would make child care facilities more available in low-income neighborhoods. This proposal, according to Rozen, has no cost. I have forwarded his letter to Karl Scholz to get Treasury's opinion, and they are supposed to respond by Monday.

Under current law, common space in LIHTC property is considered in the overall project cost (and thus, subsidized), if the area is available only to tenants of the property. This provides a disincentive to contractors to build common areas available for child care, Head Start, and other programs which can serve people from surrounding neighborhoods.

Rozen's proposal is as follows: amend the LIHTC to permit the tax credit to subsidize common areas open to nonresidents. As Rozen notes, it is important than any proposal along these lines have some limitations to make sure that the integrity of the LIHTC is not undercut. He proposes: (1) this option be available for property developed in low-income neighborhoods defined as those within census tracts where at least 50 percent of the population has an income of less than 60 percent of the area median income; (2) the common area not exceed 20 percent of the entire space of the property; and (3) the space be designed to serve individuals who at least meet the income tests for living in the property, even if they are not tenants.

WASHINGTON COUNSEL, P.C.
ATTORNEYS AT LAW

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December 12, 1997

Ms. Jennifer Klein
Special Assistant for Domestic Policy
Domestic Policy Council
The White House
1600 Pennsylvania Avenue, NW
Washington, D.C. 20500

Dear Jennifer:

I understand that you are working on policy initiatives to be included in the President's Fiscal Year 1999 budget that would increase the availability of child care options for American families. I am writing to share with you a modest, no-cost proposal that would expand the availability of child care facilities in low-income neighborhoods.

As you are probably aware, one of the factors that limits the child care options of lower income families in economically distressed areas is the lack of facilities which can serve as space for child care programs. See for example: "Early Childhood Programs, Local Perspectives on Barriers to Providing Head Start Services", General Accounting Office, GAO/HEHS-95-8; "Creating a 21st Century Head Start, Final Report of the Advisory Committee on Head Start Quality and Expansion", U.S. Department of Health and Human Services; "Early Childhood Centers, Services to Prepare Children for School Often Limited", General Accounting Office, GAO/HEHS-95-21. These studies all indicate a shortage of suitable facilities for preschool-aged children in areas that Head Start serves, that is, lower income areas. This can be a particularly acute problem that either eliminates child care options, or makes those options considerably more expensive or difficult to access. A very simple measure to help address this problem would be to permit affordable housing projects, developed with the use of the Low-Income Housing Tax Credit, to include common areas which can be made available to individuals who are not tenants of the building. Background on this issue follows:

The Low-Income Housing Tax Credit is a very successful federal tax subsidy program designed to develop affordable housing across the nation. Under this program, which has been in effect since 1987, state housing finance agencies allocate tax credits to developers of affordable housing who receive the tax subsidy in return for renting their property at limited rents to families with incomes under 60% of area median income. The Housing Credit is a capped program and the amount of credits which states may allocate each year is tied to the state's population.

Under current law, common space in a Housing Credit property which is made available only to the tenants of the property is considered part of the overall project cost and is, therefore, subsidized with the federal tax credits. However, common areas of such buildings which are made available to individuals who are not tenants of the building may not be subsidized by the housing tax credit. This has the effect of preventing the building owner from making space available for such purposes as child care, Head Start, and other programs which can serve people from the surrounding neighborhood. As a result, because of current restrictions in the Low-Income Housing Tax Credit, affordable housing that is being developed in low-income neighborhoods where there is a shortage of child care and other community facilities is not being made available to people who live in the neighborhood. This is true even in the case where local, nonprofit community groups develop and manage the property.

The solution would be to amend the law to permit the tax credit to subsidize common areas within a housing credit property even if that area is made available to individuals who do not reside within the property. There are various ways that this provision could be limited to make sure that the basic purpose of the Housing Credit program is not undermined. I have attached draft legislative language for such a provision which would be limited in various ways. Firstly, this option would only be available for property developed in low-income neighborhoods defined as those within census tracts where at least 50% of the population has an income of less than 60% of area median income. Secondly, the common area could not exceed 20% of the entire space of the property. Thirdly, the space would have to be designed to serve individuals who at least meet the income tests for living in the property, even if they are not tenants.

The policy objective -- increasing the availability of space that can be used for child care purposes -- can, of course, be achieved without these limitations. Alternatively, you may wish to consider other modifications. For example, the attached draft is prospective in nature; it would apply to future property developments. It could be modified to clarify that existing Housing Credit property will not be out of compliance with the law if space in common areas is made available to non-tenants. The essential element is that the Low-Income Housing Credit rules be liberalized to permit non-tenants to use common areas.

Since the Housing Credit is a capped program that is being fully utilized today, there should be no revenue cost to the federal government in this proposal. If you have any questions, please give me a call at (202) 293-7474.

Sincerely,

Bob Roz

Robert Rozen

Enclosure

cc: Bruce Reed
Paul Weinstein
Michael Barr
John Orszag

Increasing the Availability of Child Care Facilities In Low-Income Neighborhoods

Amendments to the Low-Income Housing Tax Credit 27 U.S.C. §42

Amend paragraph (4) of Section 42(d) by adding a new subparagraph:

(C) *BASIS OF PROPERTY IN COMMUNITY SERVICE AREAS INCLUDED. - The adjusted basis of any building located in a qualified census tract shall be determined by taking into account the adjusted basis of property (of a character subject to the allowance for depreciation) used in functionally related and subordinate community activity facilities if -*

(i) *such facilities are designed to serve individuals meeting the low-income requirements of subsection (g)(1)(B) and employees of the qualified low-income housing project of which the building is a part, and*

(ii) *not more than 20% of the aggregate eligible basis of all building in such project is attributable to the aggregate basis of such facilities.*

Such facilities the aggregate basis of which is more than 20% of such aggregate eligible basis shall not be disqualified under clause (ii), if not more than 20% of such aggregate eligible basis claimed by the taxpayer is attributable to such facilities.

From 7/10 tax mtg

Possible Democratic Package

A fully paid for Democratic package of tax cuts would likely include a core set of tax cut proposals on marriage penalties, school construction, and extension of expiring tax provisions. Additional proposals could be included to fit available remaining revenues from payfors. A menu of potential tax initiatives is given on **page 2** of the handout.

The revenue raisers listed on **page 3** have been grouped into three categories, plus tobacco. The first grouping is "relatively noncontroversial" items, totaling **$3.5 billion** through 2003. These items have been included in bipartisan tax legislation this year. The second category, totaling **$15.3 billion** through 2003, lists "less noncontroversial" raisers. Given that a tax package needs to be financed, our subjective assessment is that these would be likely additional payfors. The third category (split into two groups) is labeled "controversial." These items would have significant opposition.

Illustrative Packages:

Illustrative package 1 (on **page 4**) includes only the core tax cut proposals: a phased in marriage penalty proposal (that eventually raises the standard deduction for joints filers to twice that of singles), a school construction initiative, and extensions of expiring provisions. The core tax cuts cost **$25.8 billion** through 2003. The first two categories of raisers total **$18.8 billion** through 2003. We have assumed that the reinstatement of the two Superfund environmental taxes are used to make up the difference in the cost of cuts and payfors.

Illustrative package 2 (on **page 5**) adds child care, pension and low-income housing initiatives to the core set of tax cuts. It pays for the additional tax cuts with a 20 cent per pack increase in the cigarette excise tax through 2002 and a 30 cents per pack increase thereafter.

Discussion

Financing even the base package will involve tough choices. Some will object strongly to using the Superfund taxes to pay for tax cuts rather than environmental remediation. A likely alternative, replacing the sales source rule with activity-based rules (which has been in the President's budget the last two years), will be opposed by some who worry that this change could harm international competitiveness.

The financing constraint <u>may</u> be somewhat easier under Joint Committee scoring. Because of baseline differences, the JCT scores the liquidating REIT proposal as raising $4.4 billion more than Treasury through 2003 (and $7.6 billion more through 2008). Cutting the other way, the JCT has not scored the President's budget proposal to modify reserve rules for annuity contracts (CARV-M), which complicates inclusion in a Congressional package. The CARV-M proposal, which affects life insurance companies, would raise $4.6 billion through 2003 and $8.5 billion through 2008.

Menu for Potential Democratic Tax Package
Tax Cuts

	1998-2003	1998-2008
*Core Initiatives (** indicates very rough estimate)*		
Marriage Penalty Relief /1		
Increase the standard deduction for joint filers to double that for singles	-25,846	-55,634
Introduce a 10% second-earner deduction (up to $30k of earnings)**	-60,000	-120,000
Reduce EITC marriage penalties**	-10,000	-20,000
Gramm, Senate-passed marriage penalty proposal (already phased in) /2	-14,400	-38,600
School Construction		
School construction bonds, increase Qualified Zone Academy Bonds	-5,007	-11,552
Extend Expiring Provisions		
R&E tax credit (6/30/99) /3	-2,209	-2,218
Work Opportunity Tax Credit (4/31/00)	-783	-806
Welfare-to-Work tax credit (4/31/00)	-169	-181
Contributions of stock to private foundations (6/30/99)	-67	-67
*Additional Items if Payfors are Available (** indicates very rough estimate)*		
Make Child Care More Affordable		
Increase child and dependent care tax credit	-5,113	-11,785
Employer-provided child-care tax credit	-478	-1,268
Kennelly stay-at-home parent credit**	-3,500	-7,000
Extend Availability of Pensions /4		
3-Year subsidy plus voluntary excludable IRA -- small firms and all qualified plans	-508	-945
Simplified pension plan for small business	-304	-555
Other Pension Initiatives	-145	-395
Education Initiatives		
Extend employer-provided educational assistance and include graduate education	-1,049	-1,049
Increase Low-Income Housing Tax Credit and Urban Initiatives		
Increase per capita cap to $1.75	-1,559	-6,723
Accelerate startup of two new EZ/ECs	-63	-150
Make permanent the expensing of brownfields remediation costs	-534	-1,338
Increase Energy Efficiency and Improve the Environment		
President's climate change technology tax initiative	-3,625	-9,006
Speedup of Self-Employed Health Insurance Deduction		
Acceleration of self-employed health insurance deduction	-5,500	-8,100
Assist Taxpayers with Long-Term Care Needs		
Extend child credit to taxpayers with chronic illness and ill spouse or dependent	-4,700	-11,400
Same provision as above, but $1,000 rather than $500 credit	-9,000	-21,600
$1,000 credit for home or community care	-4,700	-11,800
Capped, 75 percent tax credit for qualified long-term care expenses	-4,600	-10,500
Simplify and Enhance the Progressivity of Capital Gains Taxation		
40 percent exclusion for long-term capital gains	-8,000	-9,000

/1 Each marriage penalty proposal can be "dialed down" to meet a smaller revenue target
/2 JCT scores this as costing $16.1b through 2003 and roughly $46b through 2008
/3 Numbers do not match the Budget because this entry includes costs in 1998 (this is $365 million)
/4 Numbers do not match the Budget because this entry includes costs in 1998 ($42 million)

Revenue Offsets
[$ in millions]

		1998-2003	1998-2008
Relatively Noncontroversial			
Modify Foreign Tax Credit carryover rules*	/1	1,925	3,391
Clarify and expand math-error procedures	/1	672	1,400
Liquidating REITs	/2	500	1,000
Constructive ownership (Kennelly)*		150	300
Clarify the meaning of "subject to" liabilities under section 357(c)	/1	120	439
Restrict special net operating loss carryback rules for specified liability losses	/1	104	255
Subtotal		3,471	6,785
Less Noncontroversial			
Modify reserve rules for annuity contracts (CARV-M)	/3	4,641	8,532
Modify corporate-owned life insurance (COLI) rules		2,455	5,253
Repeal lower-cost-or-market inventory accounting method		1,663	1,947
Reform treatment of FOGI and dual capacity taxpayers*		1,500	3,900
Reinstate Oil Spill excise tax		1,255	2,576
Eliminate non-business valuation discounts		1,008	2,468
Repeal percentage depletion for nonfuel minerals on Federal and formerly Federal lands		478	1,003
Increase proration percentage for P&C insurance companies		380	1,331
Amend 80/20 company rules		249	526
Modify treatment of foreign built-in losses		243	547
Defer deduction for interest and OID on convertible debt		166	549
Eliminate dividends-received deduction for certain preferred stock		157	611
Tighten substantial understatement penalty for large corporations		147	241
Repeal tax-free conversions of large C corporations into S corporations		144	602
Apply 7.7% rate to credit life insurance premiums		125	140
Repeal 14-day rule for vacation homes*		123	274
Extend pro-rata disallowance of tax-exempt interest expense to all financial intermediaries		109	293
Reduce "investment in the contract" for mortality and expense charges		100	1,360
Eliminate "Crummey" rule		87	213
Impose excise tax on purchase of structured settlements		82	212
Increase penalties for failure to file correct information returns		65	131
Modify depreciation method for tax-exempt use property		55	261
Modify foreign office material participation exception		50	111
Stop abuse of CFC exception to ownership requirements of IRS code section 887		30	59
Eliminate gift tax exemption for personal residence trusts		25	525
Include QTIP trust assets in surviving spouse's estate		8	21
Modify Federal Unemployment Act provisions		0	1,511
Subtotal		15,345	35,197
Controversial Ideas			
Replace sales source rule with activity-based rules (subset of Title Passage, below)		6,571	16,273
Superfund AMT tax*		3,800	5,000
Superfund excise tax*		3,600	5,000
Royalties in passive basket of foreign tax credit; 100% R&E allocation +		3,000	6,000
Reduce dividends-received deduction to 50%		1,662	3,835
Variable annuities		929	5,089
Repeal components of cost inventory method		895	2,071
Deny interest deduction on certain debt instruments		649	2,691
Subtotal		21,106	45,959
Controversial CBO & Congressional Ideas			
Excise tax on nonretirement fringe benefits (McDermott) +		**28,900**	**57,800**
Title Passage, tax repatriated FSC income+		**24,100**	**59,683**
Repeal expensing of exploration and development costs+		**4,400**	**9,100**
Repeal percentage depletion +		**2,400**	**5,100**
Minimum tax on foreign-owned business+		**1,800**	**3,600**
Runaway plants (Dorgan) +		**1,500**	**3,000**
Subtotal		63,100	138,283
Tobacco			
Accelerate cigarette excise tax increase +		3,000	3,000
10-cent tobacco excise tax (could be scaled up) +		7,500	15,000
Disallow deduction for tobacco advertising +		4,000	8,200
Subtotal		14,500	26,200

* = JCT scoring
\+ = rough guess
1. Used in the Senate's version of IRS Restructuring
2. JCT estimates at 4.9 b over five years, 8.6 b over 10 years
3. JCT has not estimated this provision

Tax Package I

Tax Cuts

(** *indicates very rough estimate)*

		1998-2003	1998-2008
Marriage Penalty Relief			
Raise joint standard deduction to twice singles (flat phase-in, jump in 2009)**		-18000	-37000
School Construction			
School construction bonds, increase Qualified Zone Academy Bonds		-5,007	-11,552
Extend Expiring Provisions			
R&E tax credit (6/30/99)		-2,209	-2,218
Work Opportunity Tax Credit (4/31/00)		-783	-806
Welfare-to-Work tax credit (4/31/00)		-169	-181
Contributions of stock to private foundations (6/30/99)		-67	-67
Subtotal		-3,228	-3,272
Total		-26,235	-51,824

Raisers

		1998-2003	1998-2008
Relatively noncontroversial			
Modify Foreign Tax Credit carryover rules	/1	1,925	3,391
Liquidating REITs**	/2	500	1,000
Clarify and expand math-error procedures	/1	672	1,400
Constructive ownership (Kennelly)**		150	300
Clarify the meaning of "subject to" liabilities under section 357(c)	/1	120	439
Restrict special net operating loss carryback rules for specified liability losses	/1	104	255
Subtotal		3,471	6,785
Less noncontroversial			
Modify reserve rules for annuity contracts (CARV-M)	/3	4,641	8,532
Modify corporate-owned life insurance (COLI) rules		2,455	5,253
Repeal lower-cost-or-market inventory accounting method		1,663	1,947
Reform treatment of FOGI and dual capacity taxpayers**		1,500	3,900
Reinstate Oil Spill excise tax		1,255	2,576
Eliminate non-business valuation discounts		1,008	2,468
Repeal percentage depletion for nonfuel minerals on Federal and formerly Federal lands		478	1,003
Increase proration percentage for P&C insurance companies		380	1,331
Amend 80/20 company rules		249	526
Modify treatment of foreign built-in losses		243	547
Defer deduction for interest and OID on convertible debt		166	549
Eliminate dividends-received deduction for certain preferred stock		157	611
Tighten substantial understatement penalty for large corporations		147	241
Repeal tax-free conversions of large C corporations into S corporations		144	602
Apply 7.7% rate to credit life insurance premiums		125	140
Repeal 14-day rule for vacation homes**		123	274
Extend pro-rata disallowance of tax-exempt interest expense to all financial intermediaries		109	293
Reduce "investment in the contract" for mortality and expense charges		100	1,360
Eliminate "Crummey" rule		87	213
Impose excise tax on purchase of structured settlements		82	212
Increase penalties for failure to file correct information returns		65	131
Modify depreciation method for tax-exempt use property		55	261
Modify foreign office material participation exception		50	111
Stop abuse of CFC exception to ownership requirements of IRS code section 887		30	59
Eliminate gift tax exemption for personal residence trusts		25	525
Include QTIP trust assets in surviving spouse's estate		8	21
Modify Federal Unemployment Act provisions		0	1,511
Subtotal		15,345	35,197
Controversial			
Superfund AMT tax		3,800	5,000
Superfund excise tax		3,600	5,000
Subtotal		7,400	10,000
Total		26,216	51,982
Net Budget Effect		-19	158

1. Used in the Senate's version of IRS Restructuring
2. JCT estimates at 4.9 b over five years, 8.6 b over 10 years
3. JCT has not estimated this provision

Tax Package II

Tax Cuts

(** *indicates very rough estimate)*

			1998-2003	1998-2008
Marriage Penalty Relief				
Raise joint standard deduction to twice singles (phased-in) **			-24,000	-51,000
School Construction				
School construction bonds, increase Qualified Zone Academy Bonds			-5,007	-11,552
Extend Expiring Provisions				
R&E tax credit (6/30/99)			-2,209	-2,218
Work Opportunity Tax Credit (4/31/00)			-783	-806
Welfare-to-Work tax credit (4/31/00)			-169	-181
Contributions of stock to private foundations (6/30/99)			-67	-67
	Subtotal		-3,228	-3,272
Make Child Care More Affordable				
Increase child and dependent care tax credit			-5,113	-11,785
Employer-provided child-care tax credit			-478	-1,268
	Subtotal		-5,591	-13,053
Extend Availability of Pensions				
3-Year subsidy plus voluntary excludable IRA -- small firms and all qualified plans			-508	-945
Simplified pension plan for small business			-304	-555
Other Pension Initiatives			-145	-395
	Subtotal		-957	-1,895
Increase Low-Income Housing Tax Credit and Urban Initiatives				
Increase per capita cap to $1.75			-1,559	-6,723
Accelerate startup of two new EZ/ECs			-63	-150
Make permanent the expensing of brownfields remediation costs			-534	-1,338
	Subtotal		-2,156	-8,211
	Total		-40,939	-88,983

Raisers

Relatively noncontroversial				
Modify Foreign Tax Credit carryover rules		/1	1,925	3,391
Liquidating REITs**		/2	500	1,000
Clarify and expand math-error procedures		/1	672	1,400
Constructive ownership (Kennelly)**			150	300
Clarify the meaning of "subject to" liabilities under section 357(c)		/1	120	439
Restrict special net operating loss carryback rules for specified liability losses		/1	104	255
	Subtotal		3,471	6,785
Less noncontroversial				
Modify reserve rules for annuity contracts (CARV-M)		/3	4,641	8,532
Modify corporate-owned life insurance (COLI) rules			2,455	5,253
Repeal lower-cost-or-market inventory accounting method			1,663	1,947
Reform treatment of FOGI and dual capacity taxpayers**			1,500	3,900
Reinstate Oil Spill excise tax			1,255	2,576
Eliminate non-business valuation discounts			1,008	2,468
Additional offsets under $500 m through 2003; identical to package I			2,823	10,521
	Subtotal		15,345	35,197
Controversial				
Superfund AMT tax			3,800	5,000
Superfund excise tax			3,600	5,000
	Subtotal		7,400	10,000
Tobacco				
20-cent per pack excise tax increase through 2002, 30 cents thereafter			15,000	37,500
	Total		41,216	89,482
	Net Budget Effect		277	499

1. Used in the Senate's version of IRS Restructuring
2. JCT estimates at 4.9 b over five years, 8.6 b over 10 years
3. JCT has not estimated this provision

Elements of a Democratic Package

A fully paid for Democratic package of tax cuts would likely include a core set of proposals on marriage penalties, school construction, and expiring tax provisions. Additional proposals would be included, subject to available payfors.

Core Tax Cut Proposals (addition material on the core cuts is given on page 5)

- **Marriage Penalty Relief**. There are several options. The first three could be phased in aggressively to minimize their cost through 2003 (the fourth, the Gramm proposal, is already aggressively phased in).

  - **Increase Standard Deduction for Joint Filers**. Increasing the standard deduction for joint filers to double the current level for single filers would cost **roughly $26 billion through 2003**.

    Fifty-four percent of the revenue loss would actually reduce marriage penalties. Couples with income (AGI) under $30,000 would receive 24 percent of the tax cut; couples with AGI over $100,000 would receive only 5 percent of the tax cut. The tax cut in 1999 for a one- or two-earner couple, each with $25,000 in earnings and no other income, and who currently use the standard deduction would be $217.50. This change would also simplify the tax system by reducing the number of taxpayers itemizing deductions by several million.

  - **Two-Earner Deduction**. The second earner deduction that existed between 1982 and 1986 could be reinstated. (This has been introduced by Herger, H.R. 2593.) The deduction was for 10 percent of the first $30,000 of the earnings of the spouse with lower earnings. This would cost **very roughly $60 billion through 2003.**

    Nearly 80 percent of the revenue loss would actually reduce marriage penalties. Couples with income (AGI) under $30,000 would receive 12 percent of the tax cut; couples with AGI over $100,000 would receive 32 percent of the tax cut. The tax cut in 1999 for a two-earner couple, each with $25,000 in earnings and no other income, would be $375.

  - **Reduction in Marriage Penalties in the EITC**. H.R. 3995 (Neal, McDermott, and Kennelly) would reduce marriage penalties in the EITC by raising the endpoint of the "plateau" for married couples filing a joint return by $3,510 (in 1999), which would also raise the income level at which the EITC is fully phased out by the same amount. This would cost **very roughly $10 billion through 2003.**

    Less than 40 percent of the revenue loss would actually reduce marriage penalties. Couples with income (AGI) under $30,000 would receive 92 percent of the tax cut; couples with AGI over $100,000 would receive none of the tax cut. The tax cut in 1999 for a one- or two-earner couple with $24,000 in total earnings, no other income, and one child would be $561.

- **Senator Gramm's Amendment to the Tobacco Bill.** The Gramm amendment would give a new deduction to married couples filing a joint return who have combined incomes below $50,000. The deduction would be equal to the difference between the sum of the standard deductions for a single filer and a head of household filer, and the standard deduction for a joint filer (this difference is $3,450 in 1999). The deduction would be available to all such couples, whether or not they itemized deductions (i.e., the deduction would be "above-the-line"). The deduction would also reduce income for purposes of the phaseout of the Earned Income Tax Credit (EITC), so couples with incomes in the phaseout range of the EITC would get a larger credit. The $50,000 income limit would be indexed for inflation after 2007. The deduction would be phased in over 10 years. This would cost **$14.4 billion through 2003** and approximately **$9 billion per year** when fully phased in.

  The new deduction would be phased in, 25 percent in 1999; 30 percent in 2000, 2001, and 2002; 40 percent in 2003, 2004 and 2005; 50 percent in 2006; 60 percent in 2007; and 100 percent in 2008 and subsequent years.

  Only 35 percent of the revenue loss would actually reduce marriage penalties. Couples with income (AGI) under $30,000 would receive 62 percent of the tax cut; couples with AGI over $100,000 would receive none of the tax cut. The tax cut when fully phased in at 1999 levels for a one- or a two-earner couple with $50,000 in total earnings and no other income, would be $518.

- **School Construction.** The Budget proposal would allow state and local governments to issue up to $9.7 billion of "qualified school construction bonds" in each of 1999 and 2000. It would also increase the limit for "qualified zone academy bonds" by $1 billion in 1999, authorize $1.4 billion of such bonds in 2000, and allow bond proceeds to be used for school construction. These provisions would cost **$5.0 billion through 2003.**

- **Extenders.** The research and experimentation tax credit, the work opportunity tax credit (WOTC), and the deduction for contributions of appreciated stock to private foundations all expired June 30. The welfare-to-work tax credit expires April 30, 1999. Extending these provisions as proposed by the President would cost **$3.2 billion through 2003.**

The Menu of Payfors

The revenue raisers (see the third page of the handout) have been grouped into three categories, plus tobacco. The first grouping is "relatively noncontroversial" items. These items have been included in bipartisan tax legislation this year. The second category are "less noncontroversial" raisers, but given that a tax package needs to be financed, our subjective assessment is that these would be likely additional payfors. The third category (split into two groups) is labeled "controversial." These items have significant opposition.

Possible Additional Tax Cut Proposals

Some of the following proposals could be included in a Democratic package, within the constraint of revenues from payfors remaining after the core proposals.

- **Child Care**. There are at least two options:

  - **Budget Proposal.** The Budget proposal would increase the maximum rate of the child and dependent care tax credit from 30 percent to 50 percent and extend eligibility for the maximum credit from $10,000 to $30,000. The proposal would also provide a new credit to employers of up to $150,000 for 25 percent of expenses incurred to build or acquire a child care facility for employee use or for providing child care services for employees. These proposals would cost **$5.6 billion through 2003**.

  - **Stay-at-home parent provision.** H.R. 4030 (Kennelly) includes the Budget proposal, and a provision that would make taxpayers with children under the age of four eligible for an expanded child credit that would be roughly equal to the average proposed increase in the child and dependent care tax credit for taxpayers under the age of four. A taxpayer could not claim both the expanded child credit and the child and dependent care tax credit. The stay-at-home piece of the Kennelly child care package would cost roughly **$3.5 billion through 2003.**

- **Pensions**. The Budget proposed promoting IRA contributions through payroll deduction, providing a tax credit to small businesses for 50 percent of the costs (up to $2,000 in the first year and $1,000 in the second year) for expenses of administering or providing employee education for a new qualified plan, the establishment of a new small business plan, and enhancing pension portability, disclosure, and simplification. These proposals would cost **$1.0 billion through 2003.**

- **Education.** Extending employer-provided educational assistance (Section 127) by one year (to 6/1/2001) and reinstating the exclusion for graduate education (effective 6/30/98 through 6/1/2001) would cost **$1.0 billion through 2003.**

- **Low Income Housing Tax Credit and Urban Initiatives.** The Budget proposal would increase the per capita limitation from $1.25 to $1.75 at a cost of **$1.6 billion through 2003.** Making the brownfields expensing provision permanent would cost **$0.5 billion through 2003.** Accelerating the startup date for the two new empowerment zones created by TRA97 by one year (to 1/1/99) would cost **0.1 billion through 2003.**

- **Climate Change.** The tax proposals in the Budget are intended to reduce energy consumption and greenhouse gas emissions by encouraging the deployment of technologies that are highly energy efficient and that use renewable energy sources. The nine initiatives in total would cost **$3.6 billion through 2003.**

- **Speedup of 100 Percent Deduction for Self-Employed Health Insurance**. Currently, the percentage of health insurance expenses that may be deducted by a self-employed individual is 45 percent. This percentage is scheduled to increase to 50 percent in 2000 and 2001, 60 percent in 2002, 80 percent in 2003 through 2005, 90 percent in 2006, and 100 percent in 2007 and thereafter. Accelerating this schedule by making the deduction 100 percent beginning in 1999 would cost **$5.5 billion through 2003**.

- **Long-Term Care**. The following are three options that might be considered:

  - **Option 1**. Providing a tax credit of $500 for taxpayers who are chronically ill, or who care for a chronically ill spouse or dependent would cost approximately **$5 billion through 2003**. Increasing the credit to $1,000 would cost approximately **$9 billion through 2003**.

  - **Option 2**. Creating a new, nonrefundable tax credit of $1,000 for taxpayers who pay for or provide home-based or community long-term care services for themselves or a chronically ill spouse or dependent would cost approximately **$4.7 billion through 2003**.

  - **Option 3**. Creating a new, nonrefundable tax credit for 75 percent of the first $2,000 of qualified long-term expenses for taxpayers with a chronic illness or chronically ill spouse or dependent would cost approximately **$4.6 billion through 2003**.

- **Capital Gains**. If it were thought desirable to have a capital gains counter to the Republican proposal, an alternative could be fashioned that would provide greater simplicity and equity.

  - One possibility would be to substitute a 40 percent exclusion for the current system of special rates. This would hold harmless or cut taxes for people in the 15 percent and 28 percent brackets (in particular, it would give taxpayers in the 15 percent bracket a rate of 9 percent on gains vs. 10 percent under current law, and taxpayers in the 28 percent bracket a rate of 16.8 percent on gains). Taxpayers in the 39.6 percent bracket would have a rate of 23.76 percent on gains (versus 20 percent under current law). Current rates are scheduled to fall to 8 percent and 18 percent for property held more than five years. The cost of a 40 percent exclusion would be roughly **$8 billion through 2003**.

Detailed Descriptions of Core Proposals

Marriage Penalty Relief

- **Increase Standard Deduction for Joint Filers**. The standard deduction for joint filers ($7,250 in 1999) would be increased to double the standard deduction for single filers ($4,350 in 1999). This would give joint filers a standard deduction of $8,700 in 1999, which is $1,450 more than under current law. For joint filers in the 15 percent bracket who use the standard deduction, this increase would reduce their taxes by $217.50. Joint filers in the 28 percent bracket who use the standard deduction would have taxes reduced by $406.

  This proposal would reduce the number of returns with itemized deductions in 1999 by 3.1 million, from 39.2 million to 36.1 million.

- **Two-Earner Deduction** (H.R. 2593; Herger). This proposal would reinstate the second earner deduction that existed between 1982 and 1986. The deduction is for 10 percent of the first $30,000 of the earnings of the spouse with lower earnings.

  This proposal violates the principal in current law that couples with identical total incomes pay identical total taxes, since only couples with two earners would receive the two-earner deduction.

- **Reduction in Marriage Penalties in the EITC** (H.R. 3995; Neal, McDermott, and Kennelly). The proposal would raise the endpoint of the "plateau" of the Earned Income Tax Credit (EITC) for married couples filing a joint return by $3,510 (from $12,510 to $16,020) in 1999. (The "plateau" is the income range in which the EITC is at a maximum.) Raising the endpoint of the "plateau" would also raise the income at which the EITC is fully phased out by the same amount ($3,510 in 1999).

  The proposal would increase "singles penalties" by **over $3 billion per year** (at 1999 income levels), because heads of households with incomes in the proposed EITC "plateau" and phaseout ranges would owe even more tax than a one-earner couple with the same income, deductions, and personal exemptions than under current law.

- **Senator Gramm's Amendment to the Tobacco Bill**. This amendment, which includes a provision to accelerate the full deduction of health insurance premiums by the self-employed, was adopted by the Senate on June 10. The marriage penalty provision would give an additional deduction to married couples filing a joint return who have combined incomes below $50,000. The deduction would be equal to the difference between the sum of the standard deductions for a single filer and a head of household filer, and the standard deduction for a joint filer (this difference is $3,450 in 1999). It would be available to all such couples, whether or not they itemized deductions (i.e., the deduction would be "above-the-line"). The deduction would also reduce income for purposes of the phaseout of the

Earned Income Tax Credit (EITC), so couples with incomes in the phaseout range of the EITC would get a larger credit. The $50,000 income limit would be indexed for inflation after 2007. The deduction would be phased in, 25 percent in 1999; 30 percent in 2000, 2001, and 2002; 40 percent in 2003, 2004 and 2005; 50 percent in 2006; 60 percent in 2007; and 100 percent in 2008 and subsequent years.

In 1999, the additional deduction would be 25% x $3,450 = $862.50, which would be worth $129 for couples with sufficient taxable income (since couples in this income range are in the 15 percent bracket). When fully phased in, the additional deduction (at the 1999 level of $3,450) would be worth $517.50. With the change in the EITC, the fully-phased-in tax reduction for a one- or two-earner couple with $24,000 in total earnings, no other income, and one child would be $1,069.

The proposal would also increase "singles penalties" by **$17 billion per year** (at 1999 income levels), because unmarried taxpayers with incomes below $50,000 would owe even more tax than a one-earner couple with the same income, deductions, and personal exemptions than under current law.

The provision would create a "cliff," whereby couples with $50,000 of income would get a tax cut of $517.50 (when fully phased in) while a couple with $1 more of income would get nothing. This creates large disincentives to earn income or large incentives to misreport income for taxpayers with incomes above the cliff.

School Construction

The Taxpayer Relief Act of 1997 enacted a provision that allows certain public schools to issue "qualified zone academy bonds," the interest on which is effectively paid by the Federal government in the form of an annual income tax credit. The proceeds of the bonds can be used for a number of purposes, including teacher training, purchases of equipment, curricular development, and rehabilitation and repair of the school facilities. The Budget proposes to institute a new program of Federal tax assistance for public school construction. Under the proposal, State and local governments would be able to issue up to $9.7 billion of "qualified school construction bonds" in each of 1999 and 2000. Holders of these bonds would receive annual federal income tax credits, set according to market interest rates by the Treasury Department, in lieu of interest. At least 95 percent of the bond proceeds of a qualified school construction bond must be used to finance public school construction or rehabilitation. The Budget also proposes to expand the amount of qualified zone academy bonds that can be issued in 1999 from $400 million to $1.4 billion and to authorize an additional $1.4 billion of qualified zone academy bonds in 2000, and to allow the proceeds of these bonds to be used for school construction.

Extension of Expiring Provisions

- **Extend the Work Opportunity Tax Credit.** The Work Opportunity Tax Credit provides an incentive for employers to hire individuals from certain targeted groups. The credit equals a percentage of qualified wages paid during the first year of the individual's employment with the employer. The credit percentage is 25 percent for employment of at least 120 hours but less than 400 hours and 40 percent for employment of 400 or more hours. The credit expires with respect to employees who begin work after June 30, 1998. The Budget proposes to extend the Work Opportunity Tax Credit so that the credit would be effective for individuals who begin work before May 1, 2000.

- **Extend for One Year the Welfare-to-Work Tax Credit.** The Welfare-to-Work Tax Credit enables employers to claim a tax credit on the first $20,000 of eligible wages paid to certain long-term family assistance recipients. The credit is 35 percent of the first $10,000 of eligible wages in the first year of employment and 50 percent of the first $10,000 of eligible wages in the second year of employment. The credit is effective for individuals who begin work before May 1, 1999. The Budget proposes to extend the Welfare-to-Work Tax Credit for one year, so that the credit would be effective for individuals who begin work before May 1, 2000.

- **Extend for One Year the R&E Tax Credit.** The Budget proposes to extend the tax credit provided for certain research and experimentation expenditures, which is scheduled to expire after June 30, 1998, for one year through June 30, 1999.

- **Contributions of Appreciated Stock to Foundations.** The special rule that allows a taxpayer to deduct the full fair market value of qualified stock donated to a private foundation expires with respect to contributions made after June 30, 1998. The Budget proposes to extend the provision to apply to contributions made during the period July 1, 1998 through June 30, 1999.

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DESCRIPTION OF THE
THE TAXPAYER REFUND ACT OF 1999

Scheduled for Markup by the
SENATE COMMITTEE ON FINANCE
on July 20, 1999

Prepared by the Staff of the
JOINT COMMITTEE ON TAXATION

D. Increase and Expand the Dependent Care Credit

Present law

In general

A taxpayer who maintains a household which includes one or more qualifying individuals may claim a nonrefundable credit against income tax liability for up to 30 percent of a limited amount of employment-related dependent care expenses. Eligible employment-related expenses are limited to $2,400 if there is one qualifying individual or $4,800 if there are two or more qualifying individuals. Generally, a qualifying individual is a dependent under the age of 13 or a physically or mentally incapacitated dependent or spouse. No credit is allowed for any qualifying individual unless a valid taxpayer identification number (ATIN@) has been provided for that individual. A taxpayer is treated as maintaining a household for a period if the taxpayer (or the taxpayer's spouse, if married) provides more than one-half the cost of maintaining the household for that period. In the case of married taxpayers, the credit is not available unless they file a joint return.

Employment-related dependent care expenses are expenses for the care of a qualifying individual incurred to enable the taxpayer to be gainfully employed, other than expenses incurred for an overnight camp. For example, amounts paid for the services of a housekeeper generally qualify if such services are performed at least partly for the benefit of a qualifying individual; amounts paid for a chauffeur or gardener do not qualify.

Expenses that may be taken into account in computing the credit generally may not exceed an individual's earned income or, in the case of married taxpayers, the earned income of the spouse with the lesser earnings. Thus, if one spouse has no earned income, generally no credit is allowed.

The 30-percent credit rate is reduced, but not below 20 percent, by 1 percentage point for each $2,000 (or fraction thereof) of adjusted gross income (AAGI@) above $10,000.

Interaction with employer-provided dependent care assistance

For purposes of the dependent care credit, the maximum amounts of employment-related expenses ($2,400/$4,800) are reduced to the extent that the taxpayer has received employer-provided dependent care assistance that is excludable from gross income (sec. 129). The exclusion for dependent care assistance is limited to $5,000 per year and does not vary with the number of children.

Description of proposal

The proposal would make two changes to the dependent care tax credit. First, the maximum credit percentage would be increased from 30 percent to 50 percent for taxpayers with AGI of $30,000 or less. The 50-percent credit rate would be decreased by one percentage point for each $1,000 of AGI, or fraction thereof, between $30,001 and $59,000. The credit percentage would be 20 percent for taxpayers with AGI of $59,001 or greater. Second, the maximum amount of eligible employment-related expenses ($2,400/$4,800).

The present-law reduction of the dependent care credit for employer-provided dependent care assistance would not be changed.

Effective date

The proposal would be effective for taxable years beginning after December 31, 2000.

E. Tax Credit for Employer-Provided Child Care Facilities

Present law

Generally, present law does not provide a tax credit to employers for supporting child care or child care resource and referral services. An employer, however, may be able to claim such expenses as deductions for ordinary and necessary business expenses. Alternatively, the employer may be required to capitalize the expenses and claim depreciation deductions over time.

Description of proposal

Employer tax credit for supporting employee child care

Under the proposal, taxpayers would receive a tax credit equal to 25 percent of qualified expenses for employee child care. These expenses would include costs incurred: (1) to acquire, construct, rehabilitate or expand property that is to be used as part of a taxpayer's qualified child care facility; (2) for the operation of a taxpayer's qualified child care facility, including the costs of training and continuing education for employees of the child care facility; or (3) under a contract with a qualified child care facility to provide child care services to employees of the taxpayer. To be a qualified child care facility, the principal use of the facility must be for child care, and the facility must be duly licensed by the State agency with jurisdiction over its operations. Also, if the facility is owned or operated by the taxpayer, at least 30 percent of the children enrolled in the center (based on an annual average or the enrollment measured at the beginning of each month) must be children of the taxpayer's employees. If a taxpayer opens a new facility, it must meet the 30-percent employee enrollment requirement within two years of commencing operations. If a new facility failed to meet this requirement, the credit would be subject to recapture.

To qualify for the credit, the taxpayer must offer child care services, either at its own facility or through third parties, on a basis that does not discriminate in favor of highly compensated employees.

Employer tax credit for child care resource and referral services

Under the proposal, a taxpayer would be entitled to a tax credit equal to 10 percent of expenses incurred to provide employees with child care resource and referral services.

Other rules

Total credits that may be claimed under this proposal would be capped at $150,000 per year. Any amounts for which the taxpayer may otherwise claim a tax deduction would be reduced by the amount of these credits. Similarly, if the credits are taken for expenses of acquiring, constructing, rehabilitating, or expanding a facility, the taxpayer's basis in the facility would be reduced by the amount of the credits.

Effective date

The credits would be effective for taxable years beginning after December 31, 2000.

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Department Of The Treasury
Office of Tax Analysis
1500 Pennsylvania Avenue, N.W.
Washington, D.C. 20220

To: Name:Nicole Radner
Firm/Organization: DPC

Fax Number:456-2878
Phone Number: 456-7263

Number of pages (including this cover sheet):

Date; Time: July 18, 1999; 3:54PM

From: Janet Holtzblatt
Phone: 202/622-1327 Fax: 202/622-0236

Comments: Roth's mark. Modified version of our CDCTC proposal (no stay-at-home piece; delayed effective date by one year; and although the amount of qualifying child care expenses is indexed, the $30,000 threshold is not).

no simplification household maintenance test

D. Increase and Expand the Dependent Care Credit

Present Law

In general

A taxpayer who maintains a household which includes one or more qualifying individuals may claim a nonrefundable credit against income tax liability for up to 30 percent of a limited amount of employment-related dependent care expenses. Eligible employment-related expenses are limited to $2,400 if there is one qualifying individual or $4,800 if there are two or more qualifying individuals. Generally, a qualifying individual is a dependent under the age of 13 or a physically or mentally incapacitated dependent or spouse. No credit is allowed for any qualifying individual unless a valid taxpayer identification number ("TIN") has been provided for that individual. A taxpayer is treated as maintaining a household for a period if the taxpayer (or the taxpayer's spouse, if married) provides more than one-half the cost of maintaining the household for that period. In the case of married taxpayers, the credit is not available unless they file a joint return.

Employment-related dependent care expenses are expenses for the care of a qualifying individual incurred to enable the taxpayer to be gainfully employed, other than expenses incurred for an overnight camp. For example, amounts paid for the services of a housekeeper generally qualify if such services are performed at least partly for the benefit of a qualifying individual; amounts paid for a chauffeur or gardener do not qualify.

Expenses that may be taken into account in computing the credit generally may not exceed an individual's earned income or, in the case of married taxpayers, the earned income of the spouse with the lesser earnings. Thus, if one spouse has no earned income, generally no credit is allowed.

The 30-percent credit rate is reduced, but not below 20 percent, by 1 percentage point for each $2,000 (or fraction thereof) of adjusted gross income ("AGI") above $10,000.

Interaction with employer-provided dependent care assistance

For purposes of the dependent care credit, the maximum amounts of employment-related expenses ($2,400/$4,800) are reduced to the extent that the taxpayer has received employer-provided dependent care assistance that is excludable from gross income (sec. 129). The exclusion for dependent care assistance is limited to $5,000 per year and does not vary with the number of children.

Description of Proposal

The proposal would make two changes to the dependent care tax credit. First, the maximum credit percentage would be increased from 30 percent to 50 percent for taxpayers with

AGI of $30,000 or less. The 50-percent credit rate would be decreased by one percentage point for each $1,000 of AGI, or fraction thereof, between $30,001 and $59,000. The credit percentage would be 20 percent for taxpayers with AGI of $59,001 or greater. Second, the maximum amount of eligible employment-related expenses ($2,400/$4,800).

The present-law reduction of the dependent care credit for employer-provided dependent care assistance would not be changed.

Effective Date

The proposal would be effective for taxable years beginning after December 31, 2000.

E. Tax Credit for Employer-Provided Child Care Facilities

Present Law

Generally, present law does not provide a tax credit to employers for supporting child care or child care resource and referral services.[4] An employer, however, may be able to claim such expenses as deductions for ordinary and necessary business expenses. Alternatively, the employer may be required to capitalize the expenses and claim depreciation deductions over time.

Description of Proposal

Employer tax credit for supporting employee child care

Under the proposal, taxpayers would receive a tax credit equal to 25 percent of qualified expenses for employee child care. These expenses would include costs incurred: (1) to acquire, construct, rehabilitate or expand property that is to be used as part of a taxpayer's qualified child care facility; (2) for the operation of a taxpayer's qualified child care facility, including the costs of training and continuing education for employees of the child care facility; or (3) under a contract with a qualified child care facility to provide child care services to employees of the taxpayer. To be a qualified child care facility, the principal use of the facility must be for child care, and the facility must be duly licensed by the State agency with jurisdiction over its operations. Also, if the facility is owned or operated by the taxpayer, at least 30 percent of the children enrolled in the center (based on an annual average or the enrollment measured at the beginning of each month) must be children of the taxpayer's employees. If a taxpayer opens a new facility, it must meet the 30-percent employee enrollment requirement within two years of commencing operations. If a new facility failed to meet this requirement, the credit would be subject to recapture.

To qualify for the credit, the taxpayer must offer child care services, either at its own facility or through third parties, on a basis that does not discriminate in favor of highly compensated employees.

Employer tax credit for child care resource and referral services

Under the proposal, a taxpayer would be entitled to a tax credit equal to 10 percent of expenses incurred to provide employees with child care resource and referral services.

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[4] An employer may claim the welfare-to-work tax credit on the eligible wages of certain long-term family assistance recipients. For purposes of the welfare-to-work credit, eligible wages includes amounts paid by the employer for dependent care assistance.

Other rules

Total credits that may be claimed under this proposal would be capped at $150,000 per year. Any amounts for which the taxpayer may otherwise claim a tax deduction would be reduced by the amount of these credits. Similarly, if the credits are taken for expenses of acquiring, constructing, rehabilitating, or expanding a facility, the taxpayer's basis in the facility would be reduced by the amount of the credits.

Effective Date

The credits would be effective for taxable years beginning after December 31, 2000.