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Family - Child Care Policy:
Tax/Subsidy

Fam-child care policy -
tax/subsidy

PROGRESSIVE POLICY INSTITUTE

January 28, 1998

Jen -
Have you seen?
Elena

Dear PPI Friend:

In his State of the Union address, President Clinton outlined a new $21.7 billion package of measures to address the child care needs of working families. With this proposal, he has pushed the question of how working parents care for their children—and how government can help them—to the top of the public agenda.

The enclosed PPI Backgrounder, *The President's Child Care Initiative: Investing in Equity,* praises the President's plans to enlarge child care block grants to the states, but argues for an alternative to the President's proposed expansion of the dependent care credit as the best way to use the tax code to help working parents. In this backgrounder, Margy Waller, senior analyst for social policy, proposes:

- directing states to treat all poor, working families equitably by creating seamless, universal child care systems with the block grant funds;
- eliminating and redirecting the existing dependent care credit, including the President's proposed $5.2 billion expansion, into the Child Tax Credit created last year;
- targeting the expansion of the Child Tax Credit to families with children under age six, and household income of less than $60,000; and
- taking steps to redesign the Child Tax Credit to be fully refundable to all working families, so that lower income households get the full benefit of the tax break.

We hope you find this backgrounder useful as the debate over this critical issue heats up.

Cordially,

Jerry Irvine
Press Secretary

PPi PROGRESSIVE POLICY INSTITUTE

Backgrounder
January 1998

The President's Child Care Initiative
Investing in Equity

by Margy Waller

With more families needing two incomes to make ends meet, and a new work-based welfare policy propelling more single mothers into the workplace, more American parents—single and married—are working than ever before. The number of mothers with preschool-age children taking jobs has increased more than five times since 1947. Today, more than 10 million children of working mothers are in child care.

Against this backdrop, the question of how working parents care for their children—and how government can help them—has risen to the top of the public agenda. President Clinton has outlined a new $21.7 billion package of measures to address the child care needs of working families—the third major child care policy initiative in as many years aimed at this growing problem.

The 1996 welfare law sent states $4 billion more in federal child care funds through the Child Care and Development Block Grant. The 1997 budget law created a new $500 Child Tax Credit ($400 in 1998) for low- and middle-income working families with children under age 17 that takes effect this year, on top of the existing income exemption for parents of children. Now the President, with considerable help from the First Lady, has proposed increasing the underfunded child care block grant and expanding the Child and Dependent Care Tax Credit (hereafter referred to as the dependent care credit, for clarity). Spending more on the block grant is a sound step, but we are skeptical about the expansion of the dependent care credit and propose in this backgrounder an alternative that will achieve more targeted and equitable ends. The President's package also includes a bundle of small initiatives.

To begin, it is a good idea to expand the federal investment in child care through state block grants. These grants provide subsidized care for the children of very low-wage workers, including families leaving the welfare system. With 3.6 million families still on state welfare caseloads, and states under increasing pressure to require recipients to work, the demands on the child care block grant are significant. As such, spending more to ensure care for the children of working welfare recipients—those in transition from welfare to work, and other low-wage working families—is consistent with "making work pay," a principle that the Progressive Policy Institute (PPI) has consistently argued should underlie welfare policy at every turn.

But the President's second idea, expanding the dependent care tax credit, while admirable in its aims, could be better targeted. First, the credit is not "refundable," and therefore does not help the many low-wage earners who have no tax liability to be reduced by the credit. Second, it is inequitable because it targets all of the resources on families who purchase child care, and discriminates against families whose economic circumstances may be similar but choose either parental or informal care for their children.

Still, the proposal is headed in the right direction, and with adjustment, can more equitably support working families with children. PPI proposes:

- Expanding the Child Care and Development Block Grant (by including the President's proposed expansion of $7.5 billion and redirecting the $9 billion in smaller initiatives to the block grant), while directing states to treat all poor, working families equitably by creating seamless, universal child care systems;

- Eliminating and redirecting the existing dependent care credit, including the President's proposed $5.2 billion expansion, into the Child Tax Credit created last year;

- Targeting the expansion of the Child Tax Credit to families with children under age six, and household incomes of less than $60,000; and

- Redesigning the Child Tax Credit to be fully refundable to all working families, so that lower-income households get the full benefit of the tax break.

Creating a Seamless Child Care System

The President's major initiative would increase spending by $7.5 billion for the Child Care and Development Block Grant states use to provide child care assistance to working poor parents. This block grant was expanded as part of the federal welfare reform legislation in 1996, and it is intended to assist welfare recipients who go to work as well as other working poor families.

However, the block grant is widely seen as insufficient to meet the expected needs of welfare recipients now required to work, and many states have reduced assistance to non-welfare working families in order to meet the needs of welfare mothers. The often-unstated foundation underlying welfare reform is that to "make work pay," state and federal governments must spend more money, and child care is perhaps the most expensive building block of this strategy. Without increased federal funding for welfare families who must work, these parents cannot otherwise afford child care. But surely no one intends the non-welfare poor to bear the burden of this expense. This outcome can be avoided only by creating a seamless and universal system of access to child care for all poor, working households.

Seamless, universal child care systems ensure that all low-wage workers with children—those on welfare and working, those in transition from welfare to work, and those with no previous receipt of welfare—have access to the same child care system. Access to a seamless system means parents don't have to find a new provider, reapply for assistance, or deal with a new set of rules as they move from welfare to workfare to low-wage, unsubsidized jobs in the regular labor market. All low-wage working parents are treated equitably in a child care system that bases eligibility for child care on income, not on current or recent receipt of welfare.

The President's proposal to increase investment in the system should be designed to move the states toward such a seamless, universal system of child care for working families that treats all poor, working families equitably and ensures that entry-level workers have the support they need to begin moving up the ladder of work—a kind of horizontal equity that is sorely needed. The question is how to steer states toward this more equitable—and practical—system. The answer is that any new federal funds should be the lever to this goal.

For years prior to the new welfare law, states urged the federal government to create one flexible block grant for child care to eliminate the crazy quilt of child care funding streams that forced states to treat families in similar economic circumstances differently. The federal welfare legislation eliminated the mandated inequities and complexities by collapsing several old programs into one block grant—though only a few states have taken full advantage of the new flexibility to create a universal and seamless system.

States can, and will, choose to draw the line for eligibility based on family income in different places; but, they should have to treat all families in similar circumstances in the same way. *That is why the Administration's proposal should require states to demonstrate on an annual basis the progress they are making toward creation of a universal, seamless system.* While such progress may be difficult to quantify, the obligation prepares states for the next step: requiring that such equitable systems be in place in exchange for federal funding when the block grant is reauthorized in 2003.

Finally, the President's proposal has *seven* other small components totaling $9 billion. There is money for a corporate tax credit, after-school programs, an early learning fund, Head Start, standards' enforcement, scholarships for child care providers, and research. With the exception of the tax credit for businesses that provide child care services to employees (which is not likely to increase business investment much), these proposals would enhance the capacity and quality of the child care system. But each alone is too small to make a significant difference. Congress should add these funds into the flexible block grant to states, while the President uses his considerable talents to educate and persuade the states to address the need to build capacity and quality in the child care system. The federal government should not dictate the means of creating an affordable, accessible, quality system of child care, but should monitor the outcomes of state policy decisions while making federal funding contingent upon the creation of a state system that meets federal goals.

Making Tax Policy for Children More Equitable

The second big idea in the White House child care proposal is to rework the dependent care credit by giving a bigger tax break to families with an annual income below $60,000 who have both a tax liability and child care expenses. The White House estimates that the new tax break would eliminate federal tax liability for families of four with household income of less than $35,000, and provide a tax break of $358 on average to other eligible taxpayers. Currently, families with child care expenses can get a tax credit of up to $1440 for two children, regardless of how much they earn. However, low-income families do not benefit from the existing dependent care credit because they don't owe any federal income tax that can be reduced by the credit. Many families will not benefit from the expansion for the same reason. Despite urging by both Democrats and Republicans in Congress, the Administration has resisted making the dependent care credit refundable. Furthermore, many of these working families are not likely to be eligible for assisted child care from block grant funds because their income is slightly higher than the eligibility limits set by individual states.

Proponents of the tax reform proposal rightly point out that the dependent care credit has not been adjusted since 1981 and needs to reflect inflation if it is going to be the principal vehicle for assisting working families with children. However, the dependent care credit has two large flaws: as noted above, it is not available to entry-level workers who do not have sufficient tax liability to receive the benefit of the credit, and it discriminates against families who do not purchase child care for their children.

A better approach would be to eliminate the dependent care credit and shift the money into the Child Tax Credit created by the 1997 budget law. This would promote simplicity, benefit all low- and moderate-income families with young children, and reward work by providing more assistance to low-income families. Taxpayers with dependent children have long been able and would still be able to take a personal exemption for each child, and the Child Tax Credit is *in addition* to the exemption. While the existing Child Tax Credit is available to working families with children under age 17, PPI proposes that the expansion benefit only families with children under age six and annual income less than $60,000, those families with the greatest expenses relative to income.

The current Child Tax Credit has the advantage of steering tax breaks to families that need it most, since it benefits only families with earnings below $120,000 (couples filing jointly), while the existing dependent care credit has no income limit. (The President's proposed expansion, however, would benefit only families with income below $60,000.) Also, the Child Tax Credit is partially refundable to families with no tax liability, while the dependent care credit is not refundable at all—and the White House does not propose to make it so. (Through a little-noted provision in the law passed in 1997 creating the Child Tax Credit, only families with more than two children are eligible for a refundable tax benefit.) Thus, the Child Tax Credit provides a more equitable distribution of tax benefits for low-wage workers than the dependent care credit. PPI proposes that over time the equity should be expanded by making the Child Tax Credit fully refundable to ensure that tax policy supports working families with the greatest needs—those with the lowest incomes.

In short, where the President proposes to give more help to moderate-income families who purchase their child care, PPI instead would spend the same money to support all working families with preschool-age children. The two tax breaks present different policy choices. One, the dependent care credit, seeks to partially reimburse *some* working families for the *cost of purchased child care*. The other, the Child Tax Credit, provides a tax break for *all working families with children*. Defenders of the White House proposal note that if we broaden the group of beneficiaries, we'll be forced to reduce the amount of support each family receives. That is true, but the imperative for tax policy intended to support families should be to reduce expenses for those with the greatest need. Of the two tax breaks, only the Child Tax Credit is refundable and therefore available to families with the greatest need for a tax break.

The shift from one tax break to the other would have only minimal impact on most families: at the same time they lose the dependent care credit, they would get the benefit of the Child Tax Credit for the first time this year. In fact, for the same amount of money as is currently expended for the dependent care credit ($2.8 billion per year), as well as the President's proposed expansion ($1 billion per year), many more families with young children would see an increase in available resources. The impact on families currently receiving the dependent care credit would be minimal since the average credit claimed in 1996 was only $445, and the maximum credit is only $720 for one child. (Of course, families with children between the ages of six and twelve would no longer get the dependent care credit and would not be eligible for PPI's proposed expansion of the Child Tax Credit on top of the existing tax credit. However, the greatest costs for child care are incurred by families with children who are not yet in school.) When fully phased in, the Child Tax Credit will be worth $500 per child—*before* adding PPI's proposed increase. Thus, few families would suffer a real loss in tax benefits, while many would gain.

Conclusion

The federal government has a legitimate role to play in helping families. First, public policy should reward work by ensuring that no family with a full-time worker lives in poverty. Creating a new employment system to replace the welfare system requires investment by both the federal government and the states. Available federal resources should be given to states with a charge to achieve this outcome without mandating the inputs. The important goal is the creation of a system to "make work pay" with all that means—assistance with health care, transportation, housing, earned income credits, and in this case, child care. The states' responsibility is to create a seamless system that treats all low-wage workers equitably. And the federal government should monitor the capacity and quality of the system created by the states. States that fail to meet federal goals should ultimately be denied ongoing federal resources.

Second, family friendly tax policy can support all low-and moderate-income families without discriminating. Very poor working parents should receive the same tax breaks as low- and moderate-income families. And these parents should be empowered to use the additional household income to choose the means of providing care to their children. The considerable commitment made by the President's proposal can be strengthened by creating a universal and seamless system of child care for the poorest working families and equitably granting tax breaks to all working families with young children.

Margy Waller is senior analyst for social policy for the Progressive Policy Institute.

For further information about PPI publications, please call the publications department at 1-800-546-0027 (in the Washington, DC, metro area: 202-544-6172), write the Progressive Policy Institute, 518 C Street, NE, Washington, DC, 20002, or visit our web site at: http://www.dlcppi.org/.

ARTICLES

Fam - child care policy - tax/subsidy

The Washington Post February 05, 1998, Thursday

Subsidies May Not Mean Parents 'Trade Up' on Day Care

BY: Steven Pearlstein, Washington Post Staff Writer

The budget President Clinton submitted this week calls for a $ 5 billion-a-year increase in government spending for day care, mostly in the form of direct subsidies for low-income families and tax credits for middle-class households.

Economists tend to be skeptical about such programs, although not dogmatically so. The economic literature is filled with studies that show how markets, left to their own devices, tend to underinvest in highways and universities and basic research or foster development of harmful monopolies. But what is the problem or failure in the marketplace that warrants government subsidies of day care?

A paper prepared by the White House Council of Economic Advisers suggests that parents, for a variety of reasons, aren't buying enough day care -- particularly the higher-quality, professional care that has long-run benefits for children and society. By using government subsidies to lower the effective price parents pay for day care, the Clinton administration argues, this market failure can be overcome.

A new study by researchers David Blau of the University of North Carolina and Alison Hagy at the Census Bureau, however, casts doubt on this argument. The results of their work are summarized in the chart at the right.

Blau and Hagy started with the observation that the hourly price of day care varied widely from one region to the other. In theory, they reasoned, one would expect that parents in the low-cost regions would purchase more and better day care than similar parents (by income, age and education) in high-priced regions.

Not so. What Blau and Hagy found was that while parents did respond to relatively lower prices by buying a bit more day care, they didn't use the opportunity to "trade up" to higher quality -- at least according to the three quality measures favored by child psychologists: classroom size, teacher training and staff-child ratio.

In fact, based on some fancy regression analyses, Blau and Hagy estimate that for every dollar of government day care subsidy, parents will, on average, buy 58 cents worth of additional day care of no better quality. The other 42 cents will be used to buy other things.

Is that an effective use of tax money? Yes and no, say economists.

There is, in fact, a fairly easy case to make for subsidizing day care for welfare mothers and other low-skilled workers.

Lawrence Katz, a labor economist at Harvard University, says there are many studies showing that a worker's wages rise very quickly during the first 10 years of employment, leading to a lifetime of higher wages and higher tax payments. But because low-skilled workers earn barely enough to pay for child care, they are unable to get and hold the kind of full-time jobs that provide that training and possibilities for upward mobility. Government subsidies -- mainly in the form of day-care vouchers -- can help bridge that gap.

The only problem with this argument, Katz concedes, is that the one group that doesn't enjoy much of a payoff from work experience is welfare mothers. But like many economists, Katz is open to the notion that this could change under harsher realities of the new welfare-reform regime.

Beside the income benefit to parents, White House economists argue that day care subsidies for low-income families also offer substantial benefits to children that spill over into the larger society.

There are a few studies, for example, showing that day-care programs can provide low-income children with important social and cognitive skills that improve academic performance in later years.

And many economists agree with Jean Kimmel of the W.E. Upjohn Institute that it is important for low-income children to have parents and role models who are connected to the mainstream economy. These benefits, she said, are crucial in breaking the welfare cycle and will show up a generation later in the form of higher employment and economic output, less crime, and reduced social welfare spending.

But while all this sounds logical, researcher Rebecca Kilburn of the Rand Corp. warns that these benefits remain so vague and hard to measure that "they certainly do not rise to the level of justifying large government expenditures."

Moreover, even if these benefits could be proved, experts say they largely do not apply to middle-income families where parents already work and professional day care is already widely used. Yet under the president's plan, these families would see the annual child-care tax credits rise from $ 480 a child to somewhere between $ 720 and $ 1,200.

In their paper, White House economists concede the only justification for such middle-class tax subsidies is that they encourage parents to invest in higher quality day care – an unlikely outcome if the Blau-Hagy study is to be believed.

One administration official speculated this week that parents in real life use quality measures different than those used by Blau and Hagy. Others hypothesized that through better regulation and public education, government can help increase the chance that parents will use the expanded credit to trade up.

But among outside economists, many agree with Blau when he observes: "This is basically a middle-class tax break, like the home mortgage deduction and the college tuition credit, that are done because they are politically popular. The economic arguments are just not very compelling."

LOWERING DAY-CARE COSTS through tax credits and government subsidies may not encourage parents to buy better day care. A new study shows that in regions where day- care prices are relatively low, parents buy more hours of day care but don't take the opportunity to trade up to higher-quality care, as measured by three common criteria.

High-price markets
Average hours of care consumed: 30.8
Average group size: 10.3
Average percent trained providers: 89%
Average staff-to-child ratio: 1:4.5
Moderate-price markets
Average hours of care consumed: 36.6
Average group size: 12.5
Average percent trained providers: 85
Average staff-to-child ratio: 1:4.7
Low-price markets
Average hours of care consumed: 45.3
Average group size: 14.7
Average percent trained providers: 79
Average staff-to-child ratio: 1:5.12

SOURCE: Blau and Hagy, Journal of Political Economy

Fam - child care
policy - tax/subsidy

EFFECTS OF PRESENT OPTION TO EXPAND CDCTC

CDCTC: The option under consideration raises the top rate from 30 percent (current law) to 50 percent and moves the phase-out range from $10,000-$28,000 (current law) to $30,000-$59,000, indexed for inflation thereafter. Under this option, the credit would phase-out at a rate of one percentage point per $1,000 of income, from a high of 50 percent at $30,000 or less of income to 20 percent at more than $59,000.

- Additional benefits to 3 million taxpayers with adjusted gross income below $59,000.
- Average tax cut of $358.
- Eliminates tax liability for most families with incomes below 200% of poverty and maximum allowable child care expenses.

Hypothetical Family Experiences	Post-Credit Income Tax Liability Under Current Law	Post-Credit Income Tax Liability Under the Proposal	Change in Tax Liability from Current Law
Single head of household with a child under 13, whose income is $20,000 and has $1,900 of child care expenses	-$927	-$1,152	-$225
Single head of household with a child under 13, whose income is $25,000, and has $2,500 of child care expenses	$569	-$103	-$672
Married couple with two children under 13, whose income is $25,000 and have $3,750 of child care expenses	-$1,246	-$1,246	0
Single head of household, with one child under 13, whose income is $35,000 and has $2,700 of child care expenses	$2,470	$1,870	-$600
Married couple with two children under 13, whose income is $35,000 and have $4,050 of child care expenses	$665	0	-$665
Single head of household, with one child under 13, whose income is $50,000 and has $2,700 of child care expenses	$5,123	$4,883	-$240
Married couple with two children under 13, whose income is $50,000 and have $4,050 of child care expenses	$2,915	$2,510	-$405

[Treasury Department Analysis shown in 1999 dollars]

Fam-child care policy -
taxes/subsidies

Nicole R. Rabner

12/19/97 02:33:31 PM

Record Type: Record

To: Bruce N. Reed/OPD/EOP
cc: Jennifer L. Klein/OPD/EOP, Elena Kagan/OPD/EOP, Michael Cohen/OPD/EOP
bcc:
Subject: Re: CCDBG

Sorry -- my last e-mail was incorrect. I believe that the Class Size phase-in figures in your e-mail add up to $7.2 not $7.3. We could add the missing $.1 from FY 1999 to class size to make up for it (i.e. 1.1 for CCDBG and 1.2 for class size), but I'm not sure we would want the first year figures to be different for the two programs.

Bruce N. Reed

Bruce N. Reed
12/19/97 01:56:22 PM

Record Type: Record

To: Nicole R. Rabner/WHO/EOP
cc: Jennifer L. Klein/OPD/EOP, Elena Kagan/OPD/EOP, Michael Cohen/OPD/EOP
Subject: Re: CCDBG

Good work. The overall fed stream from which CCDBG and class size must share is

99 - 2.3
00 - 2.6
01 - 2.9
02 - 3.3
03 - 3.7

total 14.8. (CCDBG 7.5, class size 7.3)

So hypothetically we could be

	CCDBG	Class size
99	1.1	1.1
00	1.3	1.3
01	1.45	1.45
02	1.65	1.65
03	2.0	1.7
	7.5	7.~~3~~ 2

.1 to be added in 99

Fam - child care policy -
taxes/subsidies

Nicole R. Rabner

12/19/97 01:11:39 PM

Record Type: Record

To: Bruce N. Reed/OPD/EOP

cc: Jennifer L. Klein/OPD/EOP, Elena Kagan/OPD/EOP
Subject: CCDBG

Per our conversation re: CCDBG --
To bring us to 2 million children in 2003:
*With an 80-20% match, $2 billion is needed in 2003
*With no match, $2.45 billion is needed in 2003.

Jen and I are ready to meet with you and Mike whenever is convenient this afternoon.

Nicole

Fam-child care ~~effort~~
policy - tax/subsidy
and
Fam-child care policy -
stay-at-home parents

Cynthia A. Rice 12/02/97 09:45:30 PM

Record Type: Record

To: See the distribution list at the bottom of this message

cc: Diana Fortuna/OPD/EOP, Andrea Kane/OPD/EOP
Subject: A few thoughts on today's child care meeting

Oh what fun I have been missing! That meeting made the TANF reg look easy.... A few thoughts to follow on all your real work:

Welfare vs Working Poor Families
I was a bit puzzled, as I think you were, by the dicotomy some were drawing between "welfare families" and "low-income working families." First, welfare families who need child care are working families (or they are at least preparing for work). Second, many low income women cycle on and off of welfare, using welfare as a form of unemployment insurance -- there is no bright line between the populations.

I think the key questions we should ask ourselves are: Do we want states to treat two mothers making $12,000 a year differently because one used to be on welfare and one did not? I think we do not -- we want to encourage states to develop seamless child care systems that focus on incomes, not categories. In that case, what is the best way to encourage states to develop seamless systems? I think it is not by setting benchmarks or other rules which encourage the new funds to be used for the not-formerly-on-welfare working poor to counterbalance current practice of focusing dollars on former welfare recipients. I think it is by providing funds for states to raise their eligibility criteria to include more low-income families.

We do not need new targetting of the block grant in order to have a proposal which helps moderate income working families. Even without new targetting, we can talk about any expansion of the child care and development block grant as "child care for hard working minimum wage families" or "low income families making less than $24,000 a year" and we can describe the tax credits as help for the "middle class families earning between $24,000 and $59,000."

So count me as a vote against benchmarking!

Stay at Home Parents
Regarding stay-at-home parents, I will admit I am completely unschooled in this issue. I do think we will be able to argue that we are helping stay-at-home parents through the $500 per child tax credit. I do also think, as I think you do, that an additional proposal here would be very helpful. I think such a proposal should focus on parents who stay home for more than 6-24 weeks. Thus, I would like to see something like the demonstration project idea, which would provide funds to community and religious groups (including the latter would be helpful) who provide support and assistance to stay-at-home parents, by offering parenting classes or hotlines, play groups, two hour "relief" or "emergency" child care, or which distribute materials to new parents (I thought Barry's idea of promoting connections to WIC was promising).

In fact maybe the quality fund should have two parts 1) to promote Smart Start-like local efforts to improve the quality of formal child care and 2) to promote local efforts to assist stay-at-home parents. This would allow local organizations to provide culturally-sensitive programs for parents of particularly ethnicities, which the Hispanic caucus encouraged us to do. In fact, in my in-box is the new issue of Univ of Wisconsin Institute on Poverty magazine which highlights an evaluation of a program called Avance that has worked with low-income Hispanic infants and their families in San Antonio since 1973 which has the explicit goal of "helping mothers become better teachers of their children." The evaluation found "positive and significant differences between participant and control mothers on three measures of teaching effectiveness." I can fax you a copy if you like (it's only one page).

Message Sent To:

Elena Kagan/OPD/EOP
Jennifer L. Klein/OPD/EOP
Nicole R. Rabner/WHO/EOP
Neera Tanden/WHO/EOP
Laura Emmett/WHO/EOP

Fam-child care policy - tax/subsidy

Affordability

Federal child care assistance in FY 1997 provides $2.9 billion in direct subsidies, serving a little more than one million children. However, even with this substantial investment, only 10% of eligible children receive assistance. Due to the high demand for assistance, States often set eligibility levels below the allowable income level established in the Federal statute. For example, although a State can allow families up to 85% of State Median Income to receive assistance, many States cut off eligibility at 130% of the Federal poverty level. Therefore, many working families are not eligible for direct assistance and are also unable to take advantage of the Dependent Care Tax Credit.

OPTION 1: Increase CCDBG funding without benchmarking or targeting.

Interaction with Current Program: The proposal is simply an increase in the CCDBG.

Cost Estimate: The Secretary has recommended a $700 million increase in the CCDBG to expand the number of children served with subsidies. These funds would be matched at the FMAP (which averages around 56%).

Impact Analysis: An increase of $700 million in CCDBG would provide at least 250,000 child care slots in FY 99.

Pros:

- Gives States the flexibility to spend the funds as best fits its needs.
- Enables the States to serve more working families with subsidy through the CCDBG.

Cons:

- May not be targeted enough to reach the working poor population in need of child care assistance.

OPTION 2: Increase the Child Care and Development Block Grant (CCDBG) funding and require States to set benchmarks to make care more affordable and accessible for low-income working families.

Interaction with Current Program: New funding will be provided through the CCDBG, although in order to access additional dollars, each State would have to set benchmarks, based on the State's individual situation. The benchmarks would describe how States will expand eligibility to serve more working families, make copayments more affordable, and improve reimbursement rates. For instance, if a State currently sets eligibility at 130% of the Federal poverty level, they may expand eligibility to 135% of poverty.

Cost Estimate: See Option 1 above.

Impact Analysis: An increase of $700 million in CCDBG would provide at least 250,000 child care slots in FY 99. Requiring States to set benchmarks will ensure that funds are targeted to low-income working families.

Pros:
- Retains State flexibility to use funds for the particular child care needs of their populations.
- Targets low-income working families without adding regulatory or administrative burden on the States.
- Focuses on results by requiring States to set and report on benchmarks.

Cons:
- May have to provide technical assistance to States in order for them to set appropriate and enforceable benchmarks.
- May not be sufficiently targeted to assure that funds reach specific age groups or specified income levels. However, all funds would still reach low income families that are eligible for CCDBG.

OPTION 3: Increase CCDBG funding, but require that the funds be targeted.

OPTION 3A: Target the CCDBG increase to reach families of a certain income level.

Interaction with current program: Funding would be provided through the CCDBG. Every State would be required; regardless of its individual situation, to assure that the additional money goes to families at a specified income level.

Cost Estimate: See Option 1 above.

Impact Analysis: This option would assure that additional funds are targeted to working poor families, rather than those families who are moving from welfare to work.

Pros:

- Provides a mechanism to target funds to more working poor families.

Cons:

- Limits the flexibility that States have under CCDBG to assess their own needs and allocate funds accordingly.
- Restricts States' ability to use the funds to move families from welfare to work. ?
- Recreates the type of administrative complications that the reforms in the Personal Responsibility Act were designed to eliminate.
- May not achieve its goal due to a substitution effect. For example, States may move the working families whom they already serve under this targeted funding and use the existing funding on other families, leading to no net increase in the number of working families served.

OPTION 3B: Target the CCDBG increase to reach children of a certain age.

Interaction with Current Program: Funding would be provided through the CCDBG. Every State would be required, regardless of its individual situation, to assure that the additional money goes to children in a specified age group.

Cost Estimate: See Option 1 above.

Impact Analysis: This option provides a mechanism to reach a specific targeted population based on the age of the children in the family. For instance, only a third of the children currently served are school age. Therefore, a general increase in CCDBG will proportionately only increase school age slots by over 30%. Targeting could increase the number and proportion of school age children affected. 6-12 - 0-3

Pros:

- Provides a mechanism to attempt to target funds to children in a certain age group.

Cons:

- May not achieve its goal due to a substitution effect. For example, States may move the children of a targeted age whom they already serve under this targeted funding and use the existing funding on other children, leading to no net increase in the number of children served from the specified age group.
- May restrict States' ability to serve all children in families with children of different ages (one child may be eligible while a "non-target" age child may not be eligible for the subsidy).
- Takes away the flexibility that States have under CCDBG to assess their own needs and allocate funds accordingly.
- Restricts States' ability to use the funds to move families from welfare to work, by constraining States' priorities.
- Recreates the type of administrative complications that the reforms in the Personal Responsibility Act were designed to eliminate.

Modifying the Child and Dependent Care Tax Credit

Current Law

A taxpayer may be eligible for a nonrefundable tax credit if he or she pays for the care of a qualifying individual in order to work. Qualifying individuals include children under the age of 13 and disabled dependents or spouses. The credit is equal to a percentage of the taxpayer's employment-related expenditures for child or dependent care.

The amount of the credit rate depends on the taxpayer's adjusted gross income. The credit rate is phased-down from 30 percent (for taxpayers with adjusted gross income of $10,000 or less) to 20 percent (for taxpayers with adjusted gross income above $28,000). The maximum amounts of qualifying expenses for which credits can be claimed are limited to $2,400 for one qualifying individual and $4,800 for two or more qualifying individuals. Thus, the maximum credit ranges from $480 to $720 for a taxpayer with one qualifying individual and $960 to $1,440 for a taxpayer with two or more qualifying individuals.

Employees may exclude from their taxable income (and their earnings for social security tax purposes) amounts their employers provide as child and dependent care benefits, including cafeteria plan contributions. The exclusion is limited to $5,000 of child care expenses per year 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 excludable expenses.

Options to Increase the Credit Amounts and/or to Extend Eligibility

Option 1: Beginning in 1999, taxpayers would become eligible for the 30 percent credit rate if their income is $18,000 or less. The credit rate would be phased-down from 30 percent to 20 percent for AGI between $18,000 and $45,000. In subsequent years, the starting point for the phase-down range is indexed for inflation, as are the maximum amounts of qualifying child and dependent care expenses that can be claimed for the credit or the employer exclusion.

Option 2: Beginning in 1999, taxpayers would become eligible for a 50 percent credit rate if their income is $18,000 or less. The credit rate would be phased-down from 50 percent to 20 percent for AGI between $18,000 and $47,000. In subsequent years, the starting point for the phase-down range is indexed for inflation, as are the maximum amounts of qualifying child and dependent care expenses that can be claimed for the credit or the employer exclusion.

Option 3: The child and dependent care tax credit would be made refundable in 1999, thus allowing individuals who do not have an income tax liability to claim the credit.

Option 4: In addition to making the child and dependent care tax credit refundable, the phase-down range would be adjusted as described under option 1.

Impact Analysis and Cost

Cost and Number of Families Affected by Various Options									
	Cost in Fiscal Year (millions)							Number of Taxpayers with Cut (1999)	Average Tax Cut (1999)
	1999	2000	2001	2002	2003	1999-2003	1999-2007		
Option 1	39	192	204	239	238	673	2,446	2.1 million	$74
Option 2	132	613	543	550	555	1,838	4,638	2.2 million	$223
Option 3	150	698	636	683	747	2,167	6,880	1.3 million	$409
Option 4	215	1,014	965	1,068	1,205	3,261	11,078	3.4 million	$234

Options 1 and 2: Increase Amount of Child and Dependent Care Tax Credit

Pros

- The child and dependent care tax credit parameters have not been adjusted for inflation since 1982. Options 1 and 2 essentially adjust the child and dependent care credit for inflation since 1982.

  -- In 1982, nearly 6 percent of taxpayers who benefited from the child and dependent care tax credit were eligible for the maximum credit rate of 30 percent.

  -- But in 1999, very few taxpayers will qualify for the 30 percent rate because the income threshold ($10,000) has not been increased since 1982 Options 1 and 2 increase the threshold from $10,000 to $18,000, the level it would be in 1999 if the parameters had been indexed in 1982.

- Through the tax system, assistance can be provided directly to parents for their child care needs with low administrative costs.

- Working parents can receive the credit by filing a tax return and avoid the hassles and stigma associated with applying for assistance through welfare offices.

Cons

- The child and dependent care tax credit is not well targeted to those with low income.

- Under current law, about 1 percent of the child and dependent care tax credit is received by families with money income in the bottom quintile and children under 13. About 32 percent of the credit is received by those with income in the top quintile.

- Taxpayers, who also claim the $500 child credit, will not benefit from an increase in the child and dependent care tax credit unless their income is at least between 130 and 160 percent of poverty.

- The IRS cannot easily verify child care expenditures. In 1988, about one-third of the child and dependent care tax credit amounts were overclaimed on tax returns. While compliance efforts since 1988 may have reduced this error rate, these initiatives have not significantly improved IRS's ability to verify expenditures.

Options 3 and 4: Expand Eligibility for the Credit by Making it Refundable

Pros

- Low-income taxpayers will not benefit from an expansion of the child and dependent care tax credit unless the credit is made refundable.

Cons

- Many beneficiaries of a refundable child and dependent care tax credit already are able to use the EITC to fully offset their income and payroll taxes. Hence, critics of refundability will be quick to label a new refundable child and dependent care tax credit as "welfare" and vigorously fight the proposal.

- In the past, efforts to create new refundable credits (including recent experience with the child credit) have led to increased scrutiny of the EITC and its compliance problems. Unfortunately, the EITC will remain vulnerable to such attacks until the most recent set of compliance initiatives can be fully implemented, and studies show an improvement in compliance.

- The child and dependent care tax credit will generally not be available to most taxpayers until the end of the year. But low-income parents, particularly those who are just entering the workforce, need assistance in "real-time."

Using Tax System to Improve Child Care Quality and Affordability
Jeffords Amendment

Current Law

A taxpayer may be eligible for a nonrefundable tax credit if, in order to work, he or she pays for the care of a child, a disabled dependent, or disabled spouse. The credit is equal to a percentage of the costs of care. Employees may exclude from their taxable income (and social security earnings) up to $5,000 of employer-provided child or dependent care benefits.

An individual may deduct certain expenses for education undertaken to maintain or improve a job-related skill, but only those expenses, in combination with certain other deductions, that exceed 2 percent of adjusted gross income. An individual may deduct expenses attributable to a home office if used exclusively for business. Subject to certain limits, a corporation can make deductible donations to non-taxable child care providers of property used in the business.

Description of Proposal

Last summer, Senator Jeffords offered a child care amendment to the tax bill. The child and dependent care tax credit would be made refundable, increased for moderate income taxpayers, and lowered for higher income taxpayers. Taxpayers who use accredited child care would be eligible for higher credit rates than those who do not.

Excludable employer contributions for child care would be increased for taxpayers who use accredited care. It would be lowered for taxpayers with one child who do not use accredited care. Taxpayers or their spouses would be allowed to use dependent care assistance program benefits if they stay at home to care for a newborn. ? what does this mean?

Educational expenses incurred in order to obtain child care accreditation would be exempted from the 2 percent floor on miscellaneous itemized deductions. The "exclusive use" rule governing the deductibility of home offices would be relaxed for taxpayers who conduct home-based business while caring for dependents. Corporate deductions for donations of scientific equipment could include donations to accredited child care providers. how about this?

Impact Analysis

- Low income taxpayers would become eligible for the child and dependent care tax credit. Moderate income taxpayers may receive a larger credit or exclusion of employer-provided care, particularly if they use accredited care. High income taxpayers would receive a smaller credit, but may be eligible for a larger exclusion. Stay-at-home parents of infants may benefit, but only if a spouse works for an employer who offers a child care plan. ?

Pros

- Child care would be made more affordable for many low and moderate-income taxpayers.

- Recipients do not appear to use child care subsidies to purchase higher-quality care. Basing the amount of the subsidy on the type of care may change this behavior.

- Current laws regarding the exclusive use of home office space are difficult to enforce. The proposed modifications may have the effect of legitimizing current practices.

Cons

- The IRS cannot easily verify the type of child care purchased by credit recipients. Noncompliance will increase, as taxpayers claim the higher credit rates and excludable expenses but do not use the additional subsidies to purchase high-quality care.

- Compared to a two-earner couple with the same income and child care responsibilities, the one-earner couple with a stay-at-home spouse is better off. Allowing one-earner couples access to tax-preferred funds in dependent care assistance programs worsens the inequity.

- Higher income taxpayers (with higher marginal tax rates) currently benefit disproportionately from the employer exclusion for child care and would benefit even more if they could exclude more child care expenses.

- Making child care centers safe may be a more critical need than providing pre-schoolers with access to computers.

- Child care providers will generally benefit more from the newly enacted Hope Scholarship and Lifetime Learning Credits than from a larger itemized deduction for the expense of imporving their credentials.

- Relaxing the rules on the exclusive use of home offices may introduce new enforcement and equity problems.

Revenue Estimate

JCT estimated that this provision would cost $4.11 billion over ten years.

Family- liquor initiatives

Thomas L. Freedman
11/20/97 06:11:54 PM

Record Type: Record

To: Bruce N. Reed/OPD/EOP, Elena Kagan/OPD/EOP

cc: Mary L. Smith/OPD/EOP
Subject: Alcohol as a future issue

The Problem:
*Alcohol-related injuries are the number one killer of young people under the age of 24.

* There are approximately 4 million alcoholics or problem drinkers in our country who are minors.

*78% oppose alcohol advertising that is shown on programs where at least one-fourth of the audience is under the age of 21.

* More children recognize the Budweiser Frogs than any other cartoon character except Bugs Bunny.

Some Options:

Push for legislative limits on alcohol advertising on TV, radio, magazines and billboards that target young audiences. Variations on this could follow the tobacco example: e.g., call for keeping billboards away from schools.

Require health warnings on all alcohol advertisements

Eliminate the tax deductibility of alcohol ads and promotions ($700 million)

Ban hard liquor ads on TV

Push for voluntary alcohol advertising standards. Call in the beer and wine folks to get them to voluntarily agree to guidelines for their ads-- content that does not use cartoon characters when children are watching, placing ads generally only on adult shows. (There is legislation to endorse to give them an anti-trust exemption to get together and do this.)

What About Tobacco?
My gut reaction was that the issue would have to wait for tobacco to be done, and even then everyone would be sensitive about seeming to be against another legal product-- there would be a fear of appearing puritanical and insincere. It might be that is too Washington a fear.

The use of cartoon characters to reach children is just as wrong with alcohol as it is with tobacco. Most people in the country would likely agree. If you tailor the issue to "kids and alcohol" I think it can avoid seeming political and instead be part of a consistent message. Protecting our children.
In any case, if the tobacco bill does happen early (April/May), it might be a good problem to tackle little later.

Right now there are a few bills floating around, and a few prospects for activity. Joe Kennedy has reached out to the VP and asked if he wants to do a meeting with alcohol industry people. The FCC has the hard liquor and TV advertising issue it can consider.

Regards, Tom