Credit Where Credit is $ Due

Using Tax Breaks to Help Pay for Child and Dependent Care

Tax Year 2002

Contents

Did you know that you might be eligible for tax breaks to help pay for your child and dependent care expenses and reduce the taxes you pay or increase your tax refund? This booklet is designed to inform you about four of these tax breaks in the federal income tax code: the Dependent Care Tax Credit, the Child Tax Credit, the Earned Income Tax Credit, and the Dependent Care Assistance Program. The information provided here can help you determine if you are eligible to receive the tax assistance these provisions offer for tax year 2002, give you an idea of the amount of tax assistance you can receive and how to claim it, and answer some other questions you may have about these tax breaks. This booklet is not intended to provide legal assistance but to help individuals understand their eligibility for tax breaks.

If you are eligible for the Dependent Care Tax Credit, the Child Tax Credit and the Earned Income Tax Credit, you can claim benefits under all three provisions. Under some circumstances you may be able to claim the Dependent Care Tax Credit even if you also receive benefits through a Dependent Care Assistance Program, although it is usually in your best interest to determine which of these two provides the most benefit to you and participate in that one only. You can use these tax breaks to reduce the federal income taxes you pay. Even if your income is so low that you don't pay federal income taxes, you may be able to get a tax refund by claiming the refundable Earned Income Tax Credit and/or Child Tax Credit.

This booklet is organized in four sections:

- **The 2002 Dependent Care Tax Credit, Child Tax Credit, Earned Income Tax Credit, and Dependent Care Assistance Program at a glance;**
- **Eligibility for these tax breaks;**
- **Help estimating the value of these tax breaks to you; and**
- **Information on how to claim these tax breaks, and how to obtain more information about them and similar state tax breaks.**


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DCTC
DCAP
EITC
CTC

Tax Breaks At-A-Glance

Dependent Care Tax Credit (DCTC)

The Dependent Care Tax Credit for 2002 can be as much as $720 if you paid for employment-related care in 2002 for one qualifying child or dependent, and as much as $1,440 if you paid for employment-related care in 2002 for two or more qualifying children or dependents. In general, the amount of your DCTC depends on:

- your adjusted gross income (together with your spouse's adjusted gross income, if you are married);
- the number of children or dependents in care;
- the amount you paid for care; and
- whether and to what extent you participated in a Dependent Care Assistance Program offered by your employer.

In general, the higher your child and dependent care expenses and the lower your income, the larger your DCTC will be.

Individuals and couples at all income levels are eligible for the DCTC, but if you owe no taxes, you will not benefit from the DCTC. However, even if you owe only a small amount of taxes, claiming the DCTC can increase the amount of any tax refund you may receive.

In general, the higher your child and dependent care expenses and the lower your income, the larger your DCTC will be.

Child Tax Credit (CTC)

The Child Tax Credit for 2002 can be as much as $600 for each of your qualifying children if you are single and you had 2002 modified adjusted gross income of $86,000 or less, or if you are married and you (together with your spouse) had 2002 modified adjusted gross income of $121,000 or less.

If you don't owe federal income taxes or the amount of the CTC for which you are eligible is greater than the amount of federal income taxes you owe, you can receive a refund of some or all of the CTC for which you are eligible if you (together with your spouse, if your married) had at least $10,350 in earned income for 2002.

Earned Income Tax Credit (EITC)

The Earned Income Tax Credit for 2002 can be as much as:

- $2,506 if you have one qualifying child and your 2002 earned income and adjusted gross income was $29,201 or less (if you are single), or $30,201 or less (together with your spouse's earned income and adjusted gross income, if you are married);
- $4,140 if you have two or more qualifying children and your 2002 earned income and adjusted gross income was $33,178 or less (if you are single), or $34,178 or less (together with your spouse's earned income and adjusted gross income, if you are married); and
- $376 if you have no qualifying children and you (or your spouse, if you are married) were at least age 25 but under age 65 at the end of 2002, and your 2002 earned income and adjusted gross income was $11,060 or less (if you are single), or $12,060 or less (together with your spouse's earned income and adjusted gross income, if you are married).

If you have a qualifying child, you can receive a portion of your EITC in advance—that is, in your paycheck each pay period—to help you meet your current expenses.

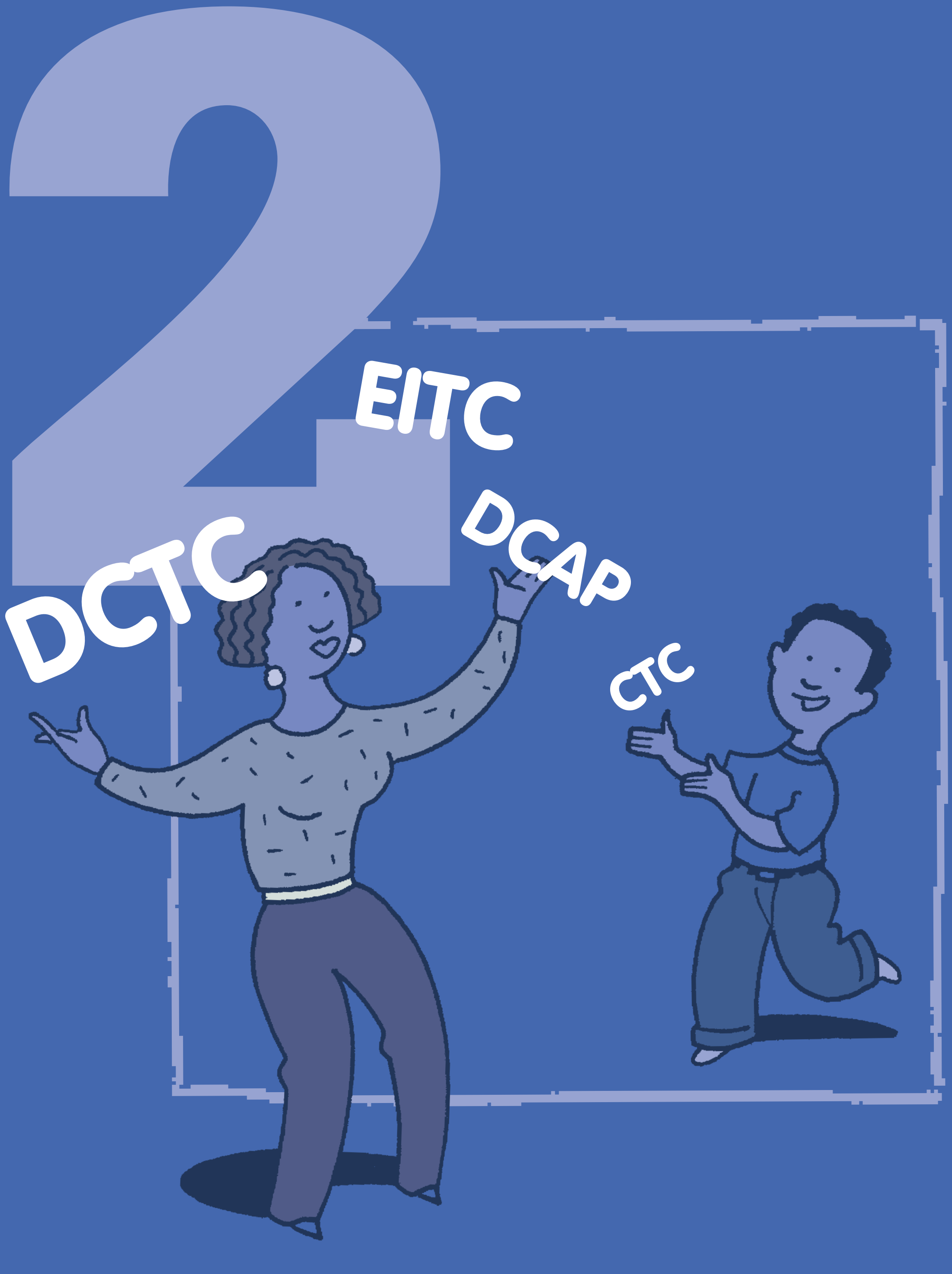
If you don't owe federal income taxes, or if the amount of the EITC for which you are eligible is greater than the amount of federal income taxes you owe, you can still receive a refund for the difference between the EITC for which you are eligible and the federal income taxes you owe.

Dependent Care Assistance Program (DCAP)

Employers are permitted to provide eligible employees up to $5,000 per year in tax-free child and dependent care benefits if the benefits are provided through a Dependent Care Assistance Program. Employees do not have to pay federal income taxes, employers do not have to pay employment taxes, and neither employers nor employees have to pay Social Security and Medicare taxes (also known as "payroll taxes") on benefits offered through a DCAP. In most states, employees do not have to pay state income taxes on these benefits either. In general, the eligibility requirements and the type of care covered under a DCAP are the same as under the DCTC.

Dependent Care Assistance Program benefits may take several forms, including cash reimbursements, vouchers, and the provision of care in an outside child or dependent care facility or in an employer's own child or dependent care facility. These benefits may be fully funded by the employer without requiring any contribution from employees. Most commonly, however, an employer establishes a DCAP as a salary-reduction plan, whereby employees are permitted to set aside amounts from their annual salaries to cover their employment-related child and dependent care expenses. A participating employee's pay is reduced by the amount the employee designates (subject to the $5,000 limitation and sometimes subject to an additional employer limitation), and this amount is returned to the employee in the form of a tax-free reimbursement for child and dependent care expenses. In effect, the assistance received by the employee is the amount of money saved by not paying taxes on the amount by which the employee's pay was reduced. Because most employers provide DCAP benefits funded solely by salary reduction, the illustrations in this booklet focus mostly on DCAP salary-reduction plans.

The size of your CTC or EITC, unlike the DCTC, does not depend upon your incurring any particular expenses but rather depends on your income, the number of children you have, and, for the EITC, your marital status.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EITC
DCAP
DCTC
CTC

Eligibility for These Tax Breaks

This section will help you determine if you can receive these tax breaks by answering some commonly asked questions about eligibility, including questions about the relationship of the tax breaks to each other and to your eligibility for specific government benefit programs.

Who is a qualifying child or dependent for the purpose of claiming the DCTC or receiving DCAP benefits, and a qualifying child for the purpose of claiming the CTC or EITC?

For DCTC/DCAP

A qualifying child is a child under age 13 at the time care was provided who lived with you in 2002 and whom you can claim as a dependent on your 2002 tax return. A qualifying dependent is 1) a disabled individual (including a child older than 13 or a parent) who lived with you in 2002, is physically or mentally incapable of self-care, and whom you claim as a dependent on your 2002 tax return, or 2) a disabled spouse who lived with you in 2002 and is physically or mentally incapable of self-care.

You can claim as a dependent on your 2002 tax return an individual 1) for whom you (and/or your spouse, if you are married) provided more than half of the support for 2002; and 2) who is your (or your spouse's, if you are married) child (grandchild, great grandchild, etc.), stepchild, sibling, stepsibling, parent (grandparent, great grandparent, etc.), stepparent, niece, nephew, aunt or uncle, or any individual who lived with you during all of 2002. There are special rules for married, adopted and foster children. Generally, an individual must be a U.S. citizen or resident alien, or a resident of Mexico or Canada, for you to be able to claim that individual as a dependent.

For CTC

A qualifying child is your child (grandchild, great grandchild, etc.) or stepchild who was under age 17 on December 31, 2002, is a U.S. citizen or resident alien, and is claimed by you as a dependent on your 2002 tax return. There are special rules for married, adopted and foster children.

For EITC

A qualifying child is your child (grandchild, great grandchild, etc.) or stepchild who lived with you in your main home in the U.S. for more than six months in 2002, and who on December 31, 2002 was under age 19, or under age 24 and a full-time student, or any age and permanently and totally disabled. There are special rules for married, adopted and foster children and for a child who is also the qualifying child of another person. The special rules for foster children and a child who is also the qualifying child of another person were liberalized beginning in 2002, making some families newly eligible for the EITC.

If I am divorced or separated from my spouse and my ex-spouse claims our child as a dependent, but I have custody of our child or share joint custody with my ex-spouse, can I claim the DCTC or receive DCAP benefits for the care of our child, or claim the CTC or EITC for our child?

For DCTC/DCAP

If you were divorced, legally separated, or lived apart from your spouse during the last six months of 2002, you can claim the DCTC or receive DCAP benefits if you incurred qualifying care expenses for the child and all of the following conditions apply: 1) you had custody of the child for a longer time in 2002 than the other parent; 2) one or both of you provided over half of the child's support in 2002; 3) one or both of you had custody of the child for more than half of 2002; and 4) the other parent claims the child as a dependent because you as the custodial parent signed Internal Revenue Service (IRS) Form 8332 or a similar statement, agreeing not to claim the child as a dependent for 2002.

For CTC/EITC

You must actually claim the child as a dependent in order to claim the CTC for the child, but you do not have to be able to claim the child as a dependent (or actually claim the child as a dependent), in order to claim the EITC for the child.

What is included in income for the purpose of claiming the DCTC, CTC and EITC, or for receiving DCAP benefits?

For DCTC/DCAP

Adjusted gross income is used to determine the amount of your DCTC. Earned income may be used to limit the amount of child and dependent care expenses that you can claim for the DCTC or the benefits you can receive through a DCAP.

For CTC

Modified adjusted gross income is used to determine your eligibility for the CTC. Earned income is used to determine your eligibility for and the amount of your CTC refund.

For EITC

Both earned income and adjusted gross income are used to determine your eligibility for and the amount of your EITC.

In general, adjusted gross income is gross income, minus certain allowable deductions. It includes wages, salaries and tips; net income from self-employment; unemployment compensation; alimony and taxable interest received. It does not include child support payments received or student loan interest and alimony paid. For most people, modified adjusted gross income is the same as adjusted gross income. Earned income is defined differently for the DCTC and DCAP than it is for the EITC and CTC. Your tax forms will help you determine what is earned income for each of these tax breaks. If you set aside part of your salary in a DCAP, you must subtract the amount you set aside in determining your adjusted gross, modified adjusted gross, and earned income.

If you set aside part of your salary in a DCAP, you must subtract the amount you set aside in determining your adjusted gross, modified adjusted gross, and earned income.

What kind of care can I use to claim the DCTC or to receive benefits through a DCAP?

Most types of child and dependent care—including in a center, a church, or a family or adult day care home, or by a neighbor or relative (except care provided by your spouse or dependent, or your child who was under the age of 19 on December 31, 2002)—qualify as long as you paid for the care and the care was necessary for you to work or look for work in paid employment. If you are married, both you and your spouse must have needed the care to work or look for work, or one spouse must have been a full-time student or incapable of self-care.

The primary purpose of the care must be for a child or dependent's well-being and protection; accordingly, amounts paid to provide food, clothing or education are not considered care expenses unless the manner of providing the care is such that it includes expenses for other benefits that are, according to the IRS "incidental to and inseparably a part of the care." The IRS illustrates this rule by stating that educational expenses for a child in the first grade or above are not considered care expenses but the full amount paid for nursery school is considered a care expense even though the school also furnishes lunch and educational services. (The IRS also takes the position informally that kindergarten expenses are not expenses for the care of a child, but has issued no written guidance to this effect.) Expenses for after-school programs and day camps during school vacations are covered, but expenses for overnight camps are not.

In addition, if the care is provided in a place that provides care for more than six persons, the provider must meet all applicable state and local regulations. In the case of a dependent, the care must be for an individual who regularly spends at least eight hours a day in the home of the person claiming the DCTC or benefiting from a DCAP, so care in a residential care facility (such as a nursing home) for spouses or other individuals who are incapable of self-care is not eligible.

Most types of child and dependent care qualify as long as you paid for the care and the care was necessary for you to work or look for work in paid employment.

Maximum child and dependent care expenses/benefits

$2,400	**DCTC** expenses for one child/dependent
$4,800	**DCTC** expenses for two children/dependents
$5,000	**DCAP** benefits

Are there limits on the child and dependent care expenses that I can claim for the DCTC or the benefits that I can receive through a DCAP?

You may not claim more than $2,400 in care expenses for one child or dependent or $4,800 in care expenses for two or more children or dependents for the DCTC, or receive more than $5,000 in benefits through a DCAP for 2002. (Your DCAP benefits are also subject to limitations that may be imposed by your employer, including limitations necessary to comply with the requirement that a DCAP not discriminate in favor of highly compensated employees.) In the case of both the DCTC and a DCAP, the care expenses you claim must be less than your 2002 earned income. If you are married, the expenses you claim must be less than your 2002 earned income or your spouse's 2002 earned income, whichever is smaller. There are special rules for calculating the earned income of a spouse who was a full-time student or incapable of self-care.

May I claim the DCTC if I receive benefits under a DCAP?

Sometimes. If you participate in a DCAP, the amount of money you receive through the DCAP must be subtracted from the child and dependent care expenses you can use to calculate the DCTC.

For example, if your employer provides you with $1,500 through a DCAP (through salary reduction or otherwise) for 2002 child care expenses, and you incur $2,000 in child care expenses in 2002, you could only claim the DCTC for $500 of your 2002 child care expenses. Similarly, because only the first $2,400 of care expenses for one child or dependent and the first $4,800 of care expenses for two or more children or dependents can serve as the basis for claiming the DCTC in 2002, if you receive more than $2,400 in 2002 DCAP benefits for one child or dependent or more than $4,800 in 2002 DCAP benefits for two or more children or dependents, you cannot claim the DCTC for 2002. Finally, if all of your 2002 child and dependent care expenses are covered by benefits received through a DCAP in 2002, you cannot claim the DCTC for 2002.

Is it better for me to participate in a DCAP or claim the DCTC?

Most people will receive more federal tax benefits from participating in a DCAP than from claiming the DCTC. However, some low-income families will receive more federal tax benefits from claiming the DCTC than from participating in a DCAP, and may actually lose some federal tax benefits by participating in a DCAP.

Most people will receive more federal tax benefits from participating in a DCAP than from claiming the DCTC.

What happens if I spend less on child and dependent care than the amount of my salary reduction for child and dependent care expenses under a DCAP?

In general, if you do not use the full amount that you designated for salary reduction at the beginning of the plan year for child or dependent care expenses over the course of the year, you will lose the right to receive the "leftover" money. This is sometimes referred to as the "use it or lose it" rule and means that it is important to be careful when designating the amount of salary reduction that you want.

Will my CTC or EITC refund affect my eligibility to receive government benefits?

Usually, no. The amount of your CTC and EITC refunds will not be used to determine if you are eligible for Medicaid, Supplemental Security Income (SSI), Food Stamps or low-income housing, nor will they be used to determine how much you can receive from those programs. Your CTC refund also will not be used to determine if you are eligible for, or how much you will receive in, Temporary Assistance for Needy Families (TANF) benefits. Each state is permitted to develop its own rules on whether the EITC refund will be used to determine eligibility for and the amount of TANF benefits, so be sure to check with your state TANF agency for the EITC rules in your state.

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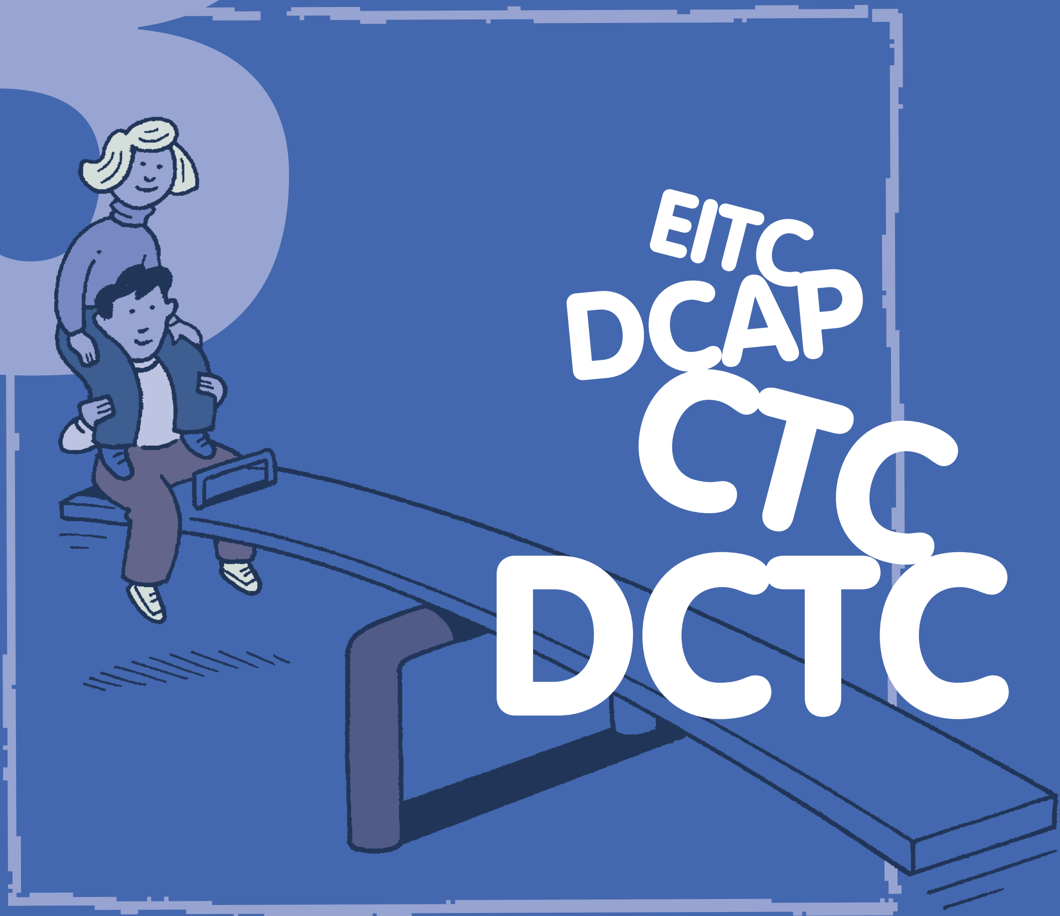

Determining the Value of the Tax Breaks

This section shows you how to estimate how much you can get from the four tax breaks and estimates the benefits for two sample families as illustrations. These are only approximations; the actual amounts you can receive will depend on your individual circumstances.

How much can I get through the EITC?

The amount you can get through the EITC depends on your income, the number of children in your family, and whether you are single or married.

You can use Table 1 or Table 2 to get an idea of how much you can receive through the EITC for 2002. Use Table 1 on page 16 if you are single. Use Table 2 on page 18 if you are married. Read down the first column until you find the dollar amount closest to your earned income or adjusted gross income level (as directed in the footnotes to the tables), remembering to subtract from your salary any reduction that may have occurred because of your participation in a DCAP. Then read across that row to the column that applies to the number of children in your family to find the approximate amount you can expect to receive from the EITC. If your income level falls between two of the dollar amounts listed, you can see the dollar range in which your EITC benefits will fall by reading across the rows for the income levels just above and just below your own. If, for example, you are single, have one qualifying child and your 2002 adjusted gross income totaled $19,000, your EITC would be between $1,470 and $1,790.

TABLE 1

Earned Income Tax Credit Amounts, Tax Year 2002
SINGLE

Earned Income/ AGI	One qualifying child	Two or more qualifying children	No qualifying children
$0	$0	$0	$0
$2,000	$680	$800	$153
$4,000	$1,360	$1,600	$306
$6,000	$2,040	$2,400	$376
$8,000	$2,506	$3,200	$234
$10,000	$2,506	$4,000	$81
$12,000	$2,506	$4,140	$0
$14,000	$2,429	$4,039	$0
$16,000	$2,110	$3,618	$0
$18,000	$1,790	$3,197	$0
$20,000	$1,470	$2,775	$0
$22,000	$1,151	$2,354	$0
$24,000	$831	$1,933	$0
$26,000	$512	$1,512	$0
$28,000	$192	$1,091	$0
$30,000	$0	$669	$0
$32,000	$0	$248	$0
$34,000+	$0	$0	$0

Use earned income if your adjusted gross income is less than $13,520. Use adjusted gross income if your adjusted gross income is more than $13,520.

The following examples illustrate how two sample families can use these tables to determine their tax savings from claiming the EITC.

Sample Family Profiles

Denise is a single mother. She has one child under age 13, works part-time, earned $25,000, and spent $1,000 on work-related child care expenses during 2002. Denise's employer offers a DCAP salary-reduction plan. She set aside $1,000 of her salary in 2002 to pay for child care expenses.

Maria and David are married and have two children under age 13. Both work full-time, and together they earned $80,000 and spent $5,000 on work-related child care expenses during 2002. Maria's employer offers a DCAP salary-reduction plan. She set aside $5,000 of her salary in 2002 to pay for child care expenses.

Denise and the EITC

Denise can expect to receive $831 from the EITC for 2002. Reading across the row in Table 1 for $24,000 in adjusted gross income (her annual salary of $25,000 minus $1,000 in DCAP salary reduction), a single individual with one child would receive $831.

Maria and David and the EITC

Maria and David are not eligible for the EITC because their 2002 adjusted gross income (their combined annual salaries of $80,000 minus $5,000 in DCAP salary reduction) are too high. Reading across the row in Table 2 for $36,000+ in income, a family with two children would receive $0.

TABLE 2

Earned Income Tax Credit Amounts, Tax Year 2002
MARRIED

Earned Income/ AGI	One qualifying child	Two or more qualifying children	No qualifying children
$0	$0	$0	$0
$2,000	$680	$800	$153
$4,000	$1,360	$1,600	$306
$6,000	$2,040	$2,400	$376
$8,000	$2,506	$3,200	$311
$10,000	$2,506	$4,000	$158
$12,000	$2,506	$4,140	$5
$14,000	$2,506	$4,140	$0
$16,000	$2,269	$3,828	$0
$18,000	$1,950	$3,407	$0
$20,000	$1,630	$2,986	$0
$22,000	$1,311	$2,565	$0
$24,000	$991	$2,144	$0
$26,000	$671	$1,722	$0
$28,000	$352	$1,301	$0
$30,000	$32	$880	$0
$32,000	$0	$459	$0
$34,000	$0	$38	$0
$36,000+	$0	$0	$0

Use earned income if your adjusted gross income (together with your spouse's adjusted gross income) is less than $14,520. Use adjusted gross income if your adjusted gross income (together with your spouse's adjusted gross income) is more than $14,520.

The amount you can get through the DCTC depends on your income, the number of children or dependents in care, and the amount you paid for care. It also depends on whether and to what extent you participated in a DCAP.

The DCTC is calculated as a percentage of qualifying child and dependent care expenses. Qualifying expenses for 2002 may not exceed $2,400 for one child or dependent and $4,800 for two or more children or dependents. Individuals and couples with 2002 adjusted gross incomes of less than $10,000 receive a credit equal to 30 percent of eligible expenses, for a maximum of $1,440. The rate decreases as adjusted gross income increases above $10,000 until it reaches 20 percent for individuals and couples with adjusted gross incomes above $28,000.

The following tables give you a general idea of how much the DCTC is worth to you by showing the amount of the DCTC available for individuals and couples at different income levels with varying child or dependent care expenses. To determine the amount of the DCTC you can expect to receive, first choose the table that applies to your situation: Table 3 if you have one child or dependent, Table 4 if you have two or more children or dependents. Look down the first column to find the dollar range in which your 2002 adjusted gross income falls, remembering to subtract from your salary any reduction that may have occurred because of your participation in a DCAP. Then read across that row to the column that most closely matches the amount you spent on child or dependent care during 2002 to find the DCTC you can expect to receive.

You may find that the exact amount you spent on child or dependent care is not listed. If this is the case, the table will provide you with the dollar range in which your DCTC will fall. Find your 2002 adjusted gross income level in the first column of the table and read across to the columns just below and just above the amount you spent. Your DCTC will fall between the two amounts listed. If, for example, your 2002 adjusted gross income was $40,000, your child care expenses were $2,200 in 2002 and you have one child, your 2002 DCTC would be between $400 and $480.

TABLE 3

Sample Child and Dependent Care Tax Credit Amounts for an Individual/Couple with One Child or Dependent, Tax Year 2002

Adjusted Gross Income	Care Expenses for One Child or Dependent			
	$1,000	$1,500	$2,000	$2,400+
$0-10,000	$300	$450	$600	$720
$10,001-12,000	$290	$435	$580	$696
$12,001-14,000	$280	$420	$560	$672
$14,001-16,000	$270	$405	$540	$648
$16,001-18,000	$260	$390	$520	$624
$18,001-20,000	$250	$375	$500	$600
$20,001-22,000	$240	$360	$480	$576
$22,001-24,000	$230	$345	$460	$552
$24,001-26,000	$220	$330	$440	$528
$26,001-28,000	$210	$315	$420	$504
$28,001+	$200	$300	$400	$480

TABLE 4

Sample Dependent Care Tax Credit Amounts for an Individual/Couple with Two or More Children or Dependents, Tax Year 2002

Adjusted Gross Income	Care Expenses for Two Children or Dependents				
	$1,000	$2,000	$3,000	$4,000	$4,800+
$0-10,000	$300	$600	$900	$1,200	$1,440
$10,001-12,000	$290	$580	$870	$1,160	$1,392
$12,001-14,000	$280	$560	$840	$1,120	$1,344
$14,001-16,000	$270	$540	$810	$1,080	$1,296
$16,001-18,000	$260	$520	$780	$1,040	$1,248
$18,001-20,000	$250	$500	$750	$1,000	$1,200
$20,001-22,000	$240	$480	$720	$960	$1,152
$22,001-24,000	$230	$460	$690	$920	$1,104
$24,001-26,000	$220	$440	$660	$880	$1,056
$26,001-28,000	$210	$420	$630	$840	$1,008
$28,001+	$200	$400	$600	$800	$960

If you have no tax liability you will not be able to benefit from the DCTC, and if your tax liability is low, you may not be able to benefit from the full amount of the DCTC for which you are otherwise eligible. This is because the DCTC, unlike the CTC and the EITC, is not refundable.

If your employer offers a DCAP and you participated in that program in 2002, the amount you can get from the DCTC will be less than the amount shown on these tables since you must subtract any DCAP benefits you received from the expenses you can use to calculate the DCTC. For example, if you received $2,200 in DCAP benefits from your employer and had $2,200 in child care expenses in 2002, you cannot claim the DCTC.

The amount of tax savings you can receive by participating in a DCAP depends on the amount of DCAP benefits your employer provides (whether through salary reduction or otherwise), since you do not pay taxes on these benefits. To determine the amount of your tax savings, you must first determine your marginal income and payroll tax rates. Your marginal tax rates are the tax rates you pay on your last dollar of income.

If you do not receive the EITC, determining your federal marginal income tax rate is relatively simple. Tables 5 and 6 give you a general idea of the federal marginal income tax rates for 2002 for families who do not receive the 2002 EITC. Use Table 5 if you are single. Use Table 6 if you are married. To estimate your federal marginal income tax rate if you do not receive the 2002 EITC, read down the first two columns of Table 5 or Table 6, as appropriate, and find the dollar range in which your 2002 adjusted gross income falls. (Remember to take into account any reduction in salary that may have occurred because of your participation in a DCAP.) Then read across that row to find your 2002 marginal income tax rate. For example, if you are single and had adjusted gross income of $40,000 in 2002, you would have a federal marginal income tax rate of 15 percent. Note that these tables assume you have only one child or other dependent. If you have more than one child or dependent, add $3,000 to each income level shown for each additional child or dependent.

The amount of tax savings you can receive by participating in a DCAP depends on the amount of DCAP benefits your employer provides (whether through salary reduction or otherwise), since you do not pay taxes on these benefits.

TABLE 5

Approximate Federal Marginal Income Tax Rates for 2002 for Single Individuals Who Do Not Receive the 2002 EITC

If your AGI is greater than...	But less than...	Your marginal income tax rate is...
0	$22,900	10%
$22,900	$50,350	15%
$50,350	$109,600	27%
$109,600	$169,500	30%
$169,500	$319,950	35%
$319,950		38.6%

This table assumes that tax filers claim the standard deduction and the personal exemption and have one child or dependent. You should add $3,000 to each income level for each additional child or dependent. If you itemize your deductions or have income too high to benefit from the personal exemption, this table will not accurately reflect your marginal tax rate.

TABLE 6

Approximate Federal Marginal Income Tax Rates for 2002 for Married Couples Who Do Not Receive the 2002 EITC

If your AGI is greater than...	But less than...	Your marginal income tax rate is...
0	$28,850	10%
$28,850	$63,550	15%
$63,550	$129,700	27%
$129,700	$188,800	30%
$188,800	$323,900	35%
$323,900		38.6%

This table assumes that tax filers claim the standard deduction and the personal exemption and have one child or dependent. You should add $3,000 to each income level for each additional child or dependent. If you itemize your deductions or have income too high to benefit from the personal exemption, this table will not accurately reflect your marginal tax rate.

If you receive the EITC, determining your federal marginal income tax rate is more complicated because it is affected by the way your EITC changes as your income changes. Because it is difficult to simplify this calculation, only a range of federal marginal income tax rates is provided here, and only for 2002 adjusted gross income levels above $13,520, if you are single, and $14,520, if you are married. (If you receive the 2002 EITC and your 2002 adjusted gross income is below these amounts, you will usually receive no federal tax savings–and may actually lose some federal EITC tax benefits–from participating in a DCAP.) If you receive the 2002 EITC and your 2002 adjusted gross income is above $13,520 (if you are single) or $14,520 (together with your spouse's adjusted gross income, if you are married), your federal marginal income tax rate ranges from 26 percent to 36 percent. (Remember to take into account any reduction in salary that may have occurred because of your participation in a DCAP.)

Table 7 gives you a general idea of the federal marginal payroll tax rates for 2002. To estimate your federal marginal payroll tax rate, read down the first two columns of Table 7 and find the dollar range in which your 2002 earnings fall, remembering to take into account any reduction in earnings that may have occurred because of your participation in a DCAP. Then read across that row to find your 2002 federal marginal payroll tax rate. For example, if you earned $40,000 in 2002, your federal marginal payroll tax rate would be 7.65 percent.

TABLE 7

Federal Marginal Payroll Tax Rates for 2002

If your earnings (together with your spouse's earnings, if you are married) are greater than...	But less than...	Your marginal payroll tax rate is...
0	$84,900	7.65%
$84,900		1.45%

The payroll tax assessed on employees is 7.65% of earnings below $84,900 and 1.45% of earnings above $84,900. If you have earnings from self-employment, this table will not accurately reflect your marginal payroll tax rate.

You can estimate your federal tax savings from participating in a DCAP by multiplying the amount of DCAP benefits your employer provides by your federal marginal tax rates and adding together the federal income and payroll tax savings. For example, if you do not receive the 2002 EITC and have a federal marginal income tax rate of 15 percent, a federal marginal payroll tax rate of 7.65 percent, and $5,000 in DCAP benefits, you would receive $750 ($5,000 x 15%) in federal income tax savings and $383 ($5,000 x 7.65%) in federal payroll tax savings. Adding these figures together gives you a rough estimate of your federal tax savings—$1,133—from participating in a DCAP.

Similarly, if you receive the 2002 EITC and your 2002 adjusted gross income (after subtracting from your salary any reduction that may have occurred because of your participation in a DCAP) is above $13,520 (if you are single) or $14,520 (together with your spouse's adjusted gross income, if you are married), you have a federal marginal income tax rate of between 26 and 36 percent and a federal marginal payroll tax rate of 7.65 percent. If you have $5,000 in DCAP benefits, you would receive between $1,300 and $1,800 ($5,000 x 26% = $1,300 and $5,000 x 36% = $1,800) in federal income tax savings and $383 ($5,000 x 7.65%) in federal payroll tax savings. Adding these figures together gives you a rough estimate of your federal tax savings–between $1,683 and $2,183–from participating in a DCAP.

If you have no tax liability and do not receive the 2002 EITC, you will receive no tax savings from participating in a DCAP. If your tax liability is low and you do not receive the 2002 EITC, you may not be able to benefit fully from the tax savings otherwise available through a DCAP. (If you receive the 2002 EITC, the value to you of participating in a DCAP will not be affected by your tax liability, but will rather depend on the extent to which your participation in a DCAP changes your earned income and adjusted gross income and therefore the size of your 2002 EITC.)

Whether it is more beneficial to you to participate in a DCAP or claim the DCTC depends on your income level, your family composition, your marital status, and the type of DCAP your employer offers.

You may also receive some state tax savings from participating in a DCAP; the amount you save will depend on your state marginal tax rate.

Most people will receive more tax benefits from participating in a DCAP than from claiming the DCTC. However, if

- you receive the 2002 EITC and your participation in a DCAP would reduce your 2002 adjusted gross income below $13,520 (if you are single) or below $14,520 (together with you spouse's adjusted gross income, if you are married), or
- you do not receive the EITC and your participation in a DCAP would reduce your 2002 adjusted gross income enough to result in your having a marginal income tax rate of 10 percent (as shown in Table 5, if you are single, or Table 6, if you are married)

you will usually receive more tax benefits from claiming the DCTC than you would from participating in a DCAP. In fact, if you receive the 2002 EITC and your participation in a DCAP would reduce your 2002 adjusted gross income below $13,520 (if you are single) or below $14,520 (together with your spouse's adjusted gross income, if you are married), you may actually lose EITC benefits by participating in a DCAP.

Because of the interaction between DCAP participation and the EITC, many but not all families who receive the EITC benefit more from participating in a DCAP than from claiming the DCTC.

If your employer offers DCAP benefits that are not funded by salary reduction, you need to add the tax savings you receive from participating in the DCAP to the amount of DCAP benefits your employer provides you over and above your full salary to determine the total value to you of participating in the DCAP. For most people whose DCAP benefits are not funded by salary reduction, the total value of participating in a DCAP will be greater than the tax savings from claiming the DCTC. However, if your DCAP benefits are partially funded by your employer and partially by salary reduction and 1) the amount contributed by your employer is less than half the amount you contribute through salary reduction, 2) you receive the 2002 EITC, and 3) your 2002 adjusted gross income (after subtracting any amount attributable to your participation in a DCAP) is less than $13,520 (if you are single) or $14,520 (together with your spouse's adjusted gross income, if you are married), you may actually lose some federal EITC tax benefits by participating in a DCAP instead of claiming the DCTC.

Finally, it is important to remember that when you set aside part of your salary in a DCAP, you reduce the amount of earnings credited to you for the purpose of determining the amount of your Social Security benefits. Although this could have some effect on the Social Security benefits you receive in the future, for most individuals the effect is very modest.

Denise and the DCTC/DCAP

Denise will receive between $337 and $437 in tax savings from participating in a DCAP. She set aside $1,000 of her salary in her employer's DCAP and received that amount in benefits to pay for child care in 2002. The value to her of participating in the DCAP is the amount of the 2002 federal income taxes and federal payroll taxes she would have paid on $1,000 if she had instead received that amount as salary. She receives the EITC, is single, and her adjusted gross income of $24,000 (her annual salary of $25,000 minus $1,000 in DCAP salary reduction) is above $13,520, so her federal marginal income tax rate is between 26 and 36 percent. Multiplying her $1,000 in DCAP benefits by these tax rates yields a federal income tax savings of between $260 and $360 ($1,000 x 26% = $260 and $1,000 x 36% = $360). Table 7 shows that with her earnings of $24,000 the marginal federal payroll tax rate is 7.65 percent. Multiplying her $1,000 in DCAP benefits by this tax rate yields a federal payroll tax savings of $77 ($1,000 x 7.65%). Denise's total federal tax savings would be between $337 and $437 (between $260 and $360 in federal income taxes and $77 in federal payroll taxes) from participating in the DCAP salary reduction plan offered by her employer.

If, however, Denise did not have access to a DCAP or otherwise did not participate in one, she could claim the DCTC for her $1,000 in child care expenses. Table 3 shows that at Denise's adjusted gross income level of $25,000 (her salary without any reduction due to participation in a DCAP) and $1,000 in child care expenses, she could expect $220 from the DCTC. Because Denise did not participate in a DCAP, she would not have any DCAP benefits to subtract from the child care expenses she could use to claim the DCTC.

These calculations confirm that Denise, who receives the EITC, is single, and has adjusted gross income above $13,520, benefits more from participating in her employer's salary-reduction DCAP (even before any state tax savings are taken into account) than from claiming the DCTC.

Example

DCTC vs. DCAP: Maria and David

DCTC	$960
DCAP benefit	$5,000
federal marginal income tax rate	x 27%
	=$1,350
DCAP benefit	$5,000
federal marginal payroll tax rate	x 7.65%
	= $383
$1,350 + $383	= $1,733

Maria and David receive more from a DCAP

Maria and David and the DCTC/DCAP

Maria set aside $5,000 of her salary in her employer's DCAP and received that amount in benefits to pay for child care expenses in 2002. Because this amount is more than the maximum expenses Maria and David can use to claim the DCTC for 2002 ($4,800), they cannot claim the DCTC.

The value of Maria and David's 2002 DCAP benefits is the amount they save by not paying 2002 taxes on the $5,000. Table 6 shows that at their adjusted gross income level of $75,000 (their combined annual salaries of $80,000 minus $5,000 in DCAP salary reduction) the federal marginal income tax rate is 27 percent. Multiplying their $5,000 in DCAP benefits by this tax rate yields a federal income tax savings of $1,350 ($5,000 x 27%). Table 7 shows that with their earnings of $75,000 the marginal federal payroll tax rate is 7.65 percent. Multiplying their $5,000 in DCAP benefits by this tax rate yields a federal payroll tax savings of $383 ($5,000 x 7.65%). Maria and David's total federal tax savings would be $1,733 ($1,350 in federal income taxes and $383 in federal payroll taxes) from participating in the DCAP salary reduction plan offered by Maria's employer.

If Maria and David did not have access to a DCAP or otherwise did not participate in one, they could instead claim the DCTC for 2002. Table 4 shows that at their adjusted gross income level of $80,000 (their combined salaries without any reduction due to participation in a DCAP) they would receive a 2002 tax benefit of $960 through the DCTC. These calculations confirm that Maria and David, who do not receive the EITC and have a marginal income tax rate above 10 percent, receive more from participating in Maria's employer's salary-reduction DCAP (even before any state tax savings are taken into account) than from claiming the DCTC.

While neither of the families in these examples both claimed the DCTC and participated in a DCAP, a family could qualify for and benefit from both. For example, if Maria's employer had allowed her to set aside only $2,800 of her salary in a DCAP, and she and David had $5,000 in 2002 child care expenses, they would also be able to claim the DCTC for 2002 since the amount of 2002 DCAP benefits they received would not exceed the maximum amount of expenses they could claim for the DCTC ($4,800). After subtracting the $2,800 they received through the DCAP from the $4,800 expense limit for the DCTC, they would have $2,000 in child care expenses to use when claiming the DCTC, and Maria's $2,800 salary reduction would lower their adjusted gross income to $77,200. They would receive $400 in 2002 tax savings from the DCTC and $970 in 2002 tax savings from the DCAP ($756 in federal income tax savings and $214 in federal payroll tax savings). Their total federal tax savings would be $1,370.

How much can I get through the CTC?

The CTC can be as much as $600 per child for single individuals with 2002 modified adjusted gross income below $86,000 and married couples with 2002 modified adjusted gross income below $121,000.

The amount you can get through the CTC depends on the number of children in your family and your income. Unlike the DCTC and DCAP, which depend on whether you have child and dependent care expenses, the CTC is available without respect to whether you have incurred any particular expenses.

The CTC is $600 per child for single individuals with 2002 modified adjusted gross income below $75,000 and married couples with 2002 modified adjusted gross income below $110,000. The CTC gradually decreases for individuals and couples with modified adjusted gross income above these amounts, until it reaches zero for single individuals with modified adjusted gross income above $86,000 and married couples with modified adjusted gross income above $121,000.

To determine how much you can receive from the CTC for 2002, multiply $600 by the number of children you have. You will receive less than this amount if your 2002 modified adjusted gross income is above $75,000 (if you are single) or above $110,000 (together with your spouse's modified adjusted gross income, if you are married). (Remember that your modified adjusted gross income may be lowered by participation in a DCAP).

Even if you pay little or no federal income taxes, you can receive all or part of the CTC as a refund, if you have sufficient earned income. Determining what this refund may be is fairly complicated to do on your own, but your tax forms walk you through the calculation. In brief, if all or some portion of the CTC is unused because the amount of your CTC exceeds the amount of taxes you owe, a further calculation is necessary to determine if you can receive all or part of the CTC as a refund. The refund you can receive for 2002 is equal to either 1) the unused portion of your CTC or 2) 10% of your (and, your spouse's, if you are married) 2002 earned income over $10,350, whichever is less. (Remember that your earned income may be lowered because of participation in a DCAP.) Special rules apply for determining the CTC refund for families with three or more children.

The CTC and EITC can be received as a refund if you have little or no tax liability.

Denise and the CTC

Denise, who has one child and modified adjusted gross income of $24,000 ($25,000 in salary minus $1,000 in DCAP salary reduction), would receive a CTC of $600 for 2002.

If Denise's income were so low that she owed less than $600 in federal income tax, she would still qualify for the CTC, part of which she would receive as a refund. If, for example, Denise had only $18,000 in 2002 earned income and modified adjusted gross income, she would have only $510 in income tax liability. Her 2002 earned income of $18,000 would be above the $10,350 threshold for claiming a CTC refund, so she would be entitled to a refund, calculated as described above. She would receive a CTC of $510 to offset her tax liability. Ten percent of her earned income above $10,350 ($7,650 x 10%) is $765. Since this amount is more than her unused CTC amount of $90, she would receive a CTC refund of $90. In total, she would receive a CTC of $600 ($510 to offset her tax liability and $90 as a refund).

Maria and David and the CTC

Maria and David, who have two children and modified adjusted gross of $75,000 ($80,000 in salary minus $5,000 in DCAP salary reduction), would receive a CTC of $1,200 ($600 x 2) for 2002.

You can claim the DCTC, CTC and EITC if you meet the eligibility requirements for each provision. As noted above, if you participate in a DCAP, your DCTC will be affected. If you receive less in DCAP benefits from your employer than you paid in child and dependent care expenses and your DCAP benefits are less than your maximum DCTC expense limit, then you can both claim the DCTC and participate in a DCAP. The expenses you can claim for the DCTC, however, will be reduced by the amount of the DCAP benefits you receive. In addition, any reduction in your income that is the result of your participation in a DCAP may affect the amount of your DCTC, EITC, or CTC.

Denise can receive between $1,768 and $1,868 in 2002 federal tax savings by participating in a DCAP and claiming the CTC and the EITC.

Example

Denise's Tax Savings

EITC	$831
DCAP	$337–437
CTC	+ $600
Total federal tax savings	between $1,768 and $1,868

Example

Maria and David's Tax Savings

EITC	$0
DCAP	+ $1,733
CTC	+ $1,200
Total federal tax savings	= $2,933

Denise will owe between $337 and $437 less in taxes as a result of her participation in a DCAP and can use her tax savings from claiming the CTC and EITC to offset her federal tax liability. At her income level she will have $1,165 in tax liability. Since the amount of her CTC and EITC ($1,431) exceeds her tax liability, she will use part of her tax savings to eliminate her tax liability and will receive a check from the IRS for the remainder ($266) as a tax refund.

Maria and David, who are not eligible for the EITC, can receive $2,933 in 2002 federal tax savings by participating in a DCAP and claiming the CTC.


4
EITC
DCTC
DCAP
CTC

How to Claim the Tax Breaks and Get More Information About Them and Similar State Tax Breaks

What do I need to do to claim the DCTC or to receive benefits through a DCAP?

To claim the DCTC, you must file a tax return. You must file either Form 1040 or 1040A (not 1040EZ) and a separate form or schedule with your tax return. With Form 1040, file Form 2441. With Form 1040A, file Schedule 2. Form 2441 and Schedule 2 do not come with either Form 1040 or 1040A; they are available at http://www.irs.gov/formspubs/index.html. Note that IRS forms and instructions refer to the DCTC as the "Credit for Child and Dependent Care Expenses."

To benefit from a DCAP, your employer must offer a DCAP and you must participate in it. You must also report the amount of your DCAP benefits on your tax return. You must file either Form 1040 or 1040A (not 1040EZ) and Form 2441 (with Form 1040) or Schedule 2 (with Form 1040A). The amount of any DCAP benefits you received during 2002 should be provided by your employer in Box 10 of your W-2 form.

To claim the DCTC or benefit from a DCAP, you must provide a Social Security number for any qualifying child or dependent. To get a Social Security number, contact your local Social Security Administration office or call the Social Security Administration's toll-free number, 1-800-772-1213. If you were married at the end of 2002, you generally must file a joint return, although special rules apply if you lived apart from your spouse.

To claim the DCTC or benefit from a DCAP, you must also have basic information about your provider, including the provider's name, address, and, if the provider is not a tax-exempt organization, an identification number (the provider's Social Security number or employer identification number). If you have tried to get your provider's identification number but have not been successful, you can explain on your return that you asked for the information but the provider did not comply with your request.

What do I need to do to claim the CTC?

Even if you don't owe any federal income taxes, you must file a tax return to claim the CTC. You must file either Form 1040 or 1040A (not 1040EZ). You must provide a Social Security number for any qualifying child. If your 2002 adjusted gross income is above $75,000 (if you are single) or above $110,000 (together with your spouse's adjusted gross income, if you are married), you must also use a worksheet in Publication 972. To claim the refundable component of the CTC, you must also file Form 8812. Publication 972 and Form 8812 do not come with either Form 1040 or 1040A; they are available at http://www.irs.gov/formspubs/index.html.

What do I need to do to claim the EITC?

Even if you don't owe any federal income taxes, you must file a tax return to claim the EITC. If you have a qualifying child, you must file either Form 1040 or 1040A (not 1040EZ) and a separate form, Schedule EIC. Schedule EIC does not come with either Form 1040 or 1040A; it is available at http://www.irs.gov/formspubs/index.html. If you have no qualifying children, you may file either Form 1040, 1040A or 1040EZ. If you were married at the end of 2002, you must file a joint return. You must provide a Social Security number for any qualifying child. If you can provide the basic information to show your eligibility, the IRS will calculate your EITC for you if you write "EIC" next to line 64 on Form 1040, or line 41 on Form 1040A, or line 8 on Form 1040EZ.

To receive a portion of your EITC in advance—that is, in your paycheck each pay period—complete Form W-5 and give it to your employer. You can give Form W-5 to your employer at any time during the year, but you should do so as early in the year as possible to begin receiving advance EITC benefits promptly. If you receive advance EITC benefits, you must file a tax return at the end of the year in order to receive the rest of your EITC benefits. Remember that you must have a qualifying child to receive advance EITC benefits. Remember also, if you elect to receive advance EITC benefits, the amount of any tax refund you could be eligible for at the end of the year will be lower than if you had waited to take all of the EITC when you file your return.

How can I get more information about these tax breaks and similar state tax breaks ?

For more information on the federal tax breaks, you can call the Internal Revenue Service at 1-800-TAX-1040 toll free or contact your local IRS Regional Manager for a current list of Volunteer Income Tax Assistance (VITA) clinics where you can get free help in filing your tax return. You can also visit the IRS web site, which provides tax forms, instructions, and other publications to assist you in filing your return, www.irs.gov.

To determine if your state offers similar credits, check with your state department of revenue or the instructions for your state income tax return, or visit www.taxadmin.org/fta/link/forms.html, which provides links to state departments of revenue and tax forms for all the states. The National Women's Law Center's publication, Making Care Less Taxing, provides information on state child and dependent care credits and deductions, available at www.nwlc.org/mclt; the Center on Budget and Policy Priorities' paper, A Hand Up, provides information on state earned income tax credits, available at www.cbpp.org/10-18-01sfp.htm.

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or www.abcdependentcare.com