Credit for Child and Dependent Care Expenses

Introduction

This lesson covers the credit for child and dependent care expenses. Some taxpayers may not be aware of this credit. Your time and effort may result in a lower tax for the taxpayers.

Calculate the credit using Form 2441, Child and Dependent Care Expenses.

CAUTION Don't confuse this credit with the child tax credit!

Objectives

At the end of this lesson, using your resource materials, you will be able to:

- Determine if a taxpayer is eligible for the credit
- Calculate the amount of the credit

What do I need?

- ☐ Form 13614-C
- ☐ Publication 4012
- ☐ Publication 17
- ☐ Form 2441 and instructions

Optional:

- ☐ Publication 503
- ☐ Form 1040 Instructions

What is a nonrefundable credit?

A nonrefundable credit is a dollar-for-dollar reduction of the tax liability. A nonrefundable credit can only reduce the tax liability to zero. The credit discussed in this lesson is a nonrefundable credit. Generally, nonrefundable credits are applied against federal tax in the order they are listed in the Tax and Credits section.

Tax Software Hint: The software will calculate these credits, but the correct information must be input. The volunteer tax preparer must make the correct determinations by using the intake and interview sheet and resource materials.

What is the child and dependent care credit?

This credit allows taxpayers to reduce their tax by a portion of their child and dependent care expenses. The credit may be claimed by taxpayers who, in order to work or look for work, pay someone to take care of their qualifying person. A qualifying person is a:

- Qualifying child under age 13
- Spouse who is incapable of self-care
- Dependent who is incapable of self-care

TIP The meaning of "incapable of self-care" is not the same as "permanently and totally disabled." Refer to the Child and Dependent Care Credit chapter in Publication 17 for more details.

The credit ranges from 20% to 35% of the taxpayer's expenses. The percentage is based on the taxpayer's earned income and adjusted gross income. The amount of the credit cannot be more than the amount of income tax on the return. It can reduce an individual's tax to $0, but it will not give the taxpayer a refund.

Some taxpayers receive dependent care benefits from their employers, which may also be called “flexible spending accounts” or “reimbursement accounts.” Taxpayers may be able to exclude these benefits from their income. Employer-provided dependent care benefits appear in the taxpayer’s Form W-2, Box 10.

Because the child and dependent care credit is a nonrefundable credit, only taxpayers with taxable income can claim the credit. However, all taxpayers who receive employer-provided dependent care benefits are required to complete Form 2441, Part III to determine if they can exclude all or part of these benefits from their taxable income.

How do I determine if a taxpayer is eligible?

The information gathered from the intake and interview sheet, along with the screening sheet in the Volunteer Resource Guide, Tab G, Nonrefundable Credits, will help you determine the taxpayer’s eligibility. Be sure to ask whether the taxpayer has paid for *any* type of dependent care, for example, for a spouse or another dependent.

The Volunteer Resource Guide screening sheet covers the five eligibility tests the taxpayer must meet to qualify for the credit:

- Qualifying person test
- Earned income test
- Work-related expense test
- Joint return test
- Provider identification test

Use the screening sheet questions in the Volunteer Resource Guide, Tab G, Nonrefundable Credits, as a guide for your interview with the taxpayer. Keep in mind that the taxpayer must pass all five of the tests to qualify for the credit.

What is the qualifying person test?

The taxpayer’s child and dependent care expenses must be for the care of one or more qualifying people. Refer to the Volunteer Resource Guide, Tab G, Nonrefundable Credits, Child and Dependent Care Credit Expenses, to determine who is a qualifying person. Any of the following are qualifying persons:

- A qualifying child who is the taxpayer’s dependent and under age 13 when the care was provided. If the child is being claimed as a dependent by the noncustodial parent under the special rules for children of divorced and separated parents, only the custodial parent may treat the child as a qualifying person for this credit.
- Someone who was physically or mentally incapable of self-care who the taxpayer claims as a dependent or for whom the taxpayer could claim, except that:
  - The person had income greater than the current year threshold amount (gross income test for a qualifying relative)
  - The person filed a joint return
  - The taxpayer or spouse, if Married Filing Jointly, could be claimed as a dependent on someone else’s current year tax return
- Spouses who were physically or mentally unable to care for themselves and lived with the taxpayer more than half the year.

example

Jim paid someone to care for his wife, Janet, so he could work. Janet is physically unable to care for herself. Jim also paid to have someone prepare meals for their 12-year-old daughter, Jill. Both Janet and Jill are qualifying persons for the credit.

TIP See the rules for Qualifying Child and the special rules for children of divorced or separated parents or parents who live apart in Publication 17, Personal Exemptions and Dependents.

What questions should I ask?

Ask the questions from the screening sheet in the Volunteer Resource Guide, Tab G, Nonrefundable Credits, and the intake and interview sheet. The sample interview shown uses these questions.

SAMPLE INTERVIEW

VOLUNTEER SAYS...	DOROTHY RESPONDS...
I see you indicated on your intake sheet that you had child and dependent care expenses.	Yes, I did.
You may qualify for the child and dependent care credit. Let me ask you a few questions about that. Which of your dependents received the care?	My daughter.
Now, she is 16 years old, correct?	Yes, but she was diagnosed with a severe mental condition. She just can't take care of herself.

Even though Dorothy's daughter is over age 13, she meets the qualifying person test because she cannot care for herself.

Once you've determined if the taxpayer had eligible expenses for the child and dependent care credit, confirm that the appropriate box on the intake and interview sheet is checked.

What is the earned income test?

The taxpayer (and spouse, if married) must both have earned income during the year. Earned income includes:

- Wages
- Salaries
- Tips
- Other taxable employee compensation
- Net earnings from self-employment
- Strike benefits
- Disability pay reported as wages

CAUTION Earned income does not include amounts reported as wages that are excluded as foreign earned income on Form 2555, Foreign Earned Income.

It does not include income earned while incarcerated or in a work release program.

Refer to the Volunteer Resource Guide, Tab I, Earned Income Credit, Earned Income Table for the list of earned income.

What if spouses are full-time students or are unable to care for themselves?

A taxpayer's spouse is treated as having earned income for any month the spouse is physically or mentally incapable of self-care, or is a full-time student. The spouse's income is considered to be $250 for each month if there is one qualifying person in the home or $500 each month if there are two or more qualifying people. A full-time student is defined as enrolled and attending a school for the number of hours or classes the school considers full time. The spouse must be a full-time student for some part of five calendar months during the year.

If, in the same month, both the taxpayer and the taxpayer's spouse are full-time students or are not able to care for themselves, only one spouse can be considered to have earned income of either $250 for one qualifying person or $500 for two qualifying persons for that month.

Tax Software Hint: To review information related to the software, go to the Volunteer Resource Guide, Tab G, Nonrefundable Credits, Form 2441, Credit for Child and Dependent Care Expenses.

What questions should I ask?

Ask the questions from the screening sheet in the Volunteer Resource Guide, Tab G, Nonrefundable Credits and the intake and interview sheet. Here is how a volunteer might interview a taxpayer about this test.

SAMPLE INTERVIEW

VOLUNTEER SAYS...	DOROTHY RESPONDS...
I believe you mentioned earlier that you and your husband both work. Is that correct?	Yes.
Did you both work while your daughter was in day care?	Yes and no. My husband just changed careers. He went to school the first half of the year, but he began working full time within a month of finishing his program in July.
So, he was a full-time student for the first six months of the tax year?	Yes. Does that disqualify us?
No. That does not disqualify you.	

Dorothy and her husband meet the earned income test because her husband was a full-time student for at least five months and is considered to have earned income for those months.

What is the work-related expense test?

Expenses are considered work-related only if both of the following are true:

- The expenses allow the taxpayer (and spouse, if married) to work or look for work and
- The expenses are for a qualifying person's care, and to provide for that person's well-being and protection

For married taxpayers, generally both must work or be looking for work. Taxpayers' spouses are treated as working during any month the spouses were full-time students or were physically or mentally unable to take care of themselves.

There is a limit on the amount of work-related expenses that can be used to figure the credit. The limit is $3,000 for one qualifying person and $6,000 for two or more qualifying persons. This $6,000 limit does not need to be divided equally among them.

What are examples of work-related expenses?

The following expenses count as work-related:

- Cost of care outside the home for dependents under age 13, for example, preschool or home day care, before- or after-school care for a child in kindergarten or higher grade
- Cost of care for any other qualifying person, for example, dependent care
- Household expenses that are paid at least partly for the well-being and protection of a qualifying person, for example, the services of a housekeeper or cook

TIP If a taxpayer's qualifying child turned 13 during the tax year, their qualifying expenses include amounts incurred for the child while under age 13. For example, if the taxpayer's qualifying child turns 13 on September 16, count only those expenses through September 15.

What expenses do not qualify as work-related?

Expenses that do not qualify as work-related include amounts paid for food, clothing, education, or entertainment. However, small amounts paid for these items can be included if they are incidental to and cannot be separated from the cost of care. Examples of childcare expenses that do **not** qualify as work-related include:

- Education expenses to attend kindergarten or a higher grade
- The cost of sending a child to an overnight camp
- The cost of transportation not provided by a care provider

example

Roger takes his 10-year-old child to a private school. In addition to paying for the cost of the education, Roger also pays an extra fee so that his child can attend a before- and after-school program while he is at work. Roger can count the cost of the before- and after-school program when figuring the credit, but not the cost of the education.

example

Krista takes her 3-year-old child to a nursery school that provides lunch and educational activities as part of its preschool childcare service. She can count the total cost when she figures the credit.

What about taxes paid for household employees?

Taxpayers who paid someone to come into their home to provide care for their dependent or spouse may be required to pay household employment taxes. These taxes may be considered a work-related expense. Refer to Publication 17, Employment Taxes for Household Employers section, for more information.

Generally, if the household employee earned less than a certain amount for the tax year, and the taxpayer did not withhold any income tax, the taxpayer is not required to pay employment taxes or provide the employee with Form W-2. Refer taxpayers who did not pay employment taxes for their household employees, and are unsure about these requirements, to Publication 926, Household Employer's Tax Guide, or to a professional tax preparer.

What if the taxpayer makes payments to a relative?

Payments to relatives may qualify as work-related expenses if the taxpayer does not claim the relative as a dependent. Do not count amounts paid to:

- A dependent that the taxpayer (or spouse, if married) can claim on the tax return
- The taxpayer's child who is under age 19 at the end of the year, even if the child is not the taxpayer's dependent
- A person who was the taxpayer's spouse at any time during the year
- The other parent of the taxpayer's qualifying child who is under age 13

What questions should I ask?

Continue asking questions from the screening sheet in the Volunteer Resource Guide, Tab G, Nonrefundable Credits, and the intake and interview sheet. Here is how a volunteer might interview a taxpayer about the work-related test.

SAMPLE INTERVIEW

VOLUNTEER SAYS...	DOROTHY RESPONDS...
Did the caregivers assist your daughter only when you and your husband were at work?	That's right. We couldn't afford any more help than that. All last year, they arrived just before we left for work and they left when my mother came at 2 p.m.
Do you pay your mother to care for your daughter?	No, we don't. She just does it because she loves her granddaughter.
That's wonderful. You're all very fortunate. So all your expenses were only to allow you to work – or in your husband's case to go to school or look for work prior to becoming employed.	Yes, exactly.

Dorothy passes the work-related expense test because the expenses are paid so that she and her husband can work and are not paid to a dependent relative.

What is the joint return test?

Generally, *married couples* who wish to take the child and dependent care credit must file a joint return. However, taxpayers can be considered unmarried if they file a separate return and:

- Are legally separated under a divorce or separate maintenance decree on the last day of the tax year or
- Lived apart from their spouse for the last 6 months of the year and paid more than half of the cost of providing a home that was also the main home of the qualifying person for more than half the year.

CAUTION There is a checkbox required on Form 2441 for Married filing Separately taxpayers that meet the requirements to claim the credit.

TIP Generally, married persons who are considered unmarried will use the filing status, Head of Household.

A taxpayer whose spouse died during the tax year, and who has not remarried, must generally file a joint return to claim the credit.

At this point, you will have already determined the filing status and can rely on that to determine if the taxpayer passes the joint return test.

What is the provider identification test?

The provider identification test requires that taxpayers provide the name, address and Taxpayer Identification Number (TIN) of the person or organization who provided the care for their child or dependent.

If the care provider is an individual, the TIN is the same as the provider's Social Security number. If the provider is an organization, then it is the Employer Identification Number (EIN). Certain tax-exempt organizations are not required to have an EIN. See Publication 17 for more details.

Taxpayers who cannot provide all of the provider's information or who have incorrect information may still be able to take the credit if they can show that they used due diligence in trying to obtain the correct information. Refer to the sections titled Due Diligence and Provider Refusal in Publication 17, Child and Dependent Care chapter, for more information. Returns that do not include the provider information cannot be filed electronically.

EXERCISES

Use the screening sheet in the Volunteer Resource Guide, Tab G, Nonrefundable Credits, to answer the following questions. The answers appear at the end of the lesson.

Question 1: Audrey is a stay-at-home mom. Her husband works and had earned income for the tax year. They have a young son with autism who must be supervised at all times. Audrey volunteers at a local autism information hotline 12 hours a week. She and her husband pay a caregiver to stay with their son during those hours.

Do they qualify for the child and dependent care credit? ☐ Yes ☐ No

Question 2: Why don't Audrey and her husband qualify for the credit? (Select all answers that apply.)

A. The caregiver expense is not work-related

B. Their son is not a qualifying person

C. The caregiver's duties qualify as work-related

D. They do not pass the earned income test

Taxpayer Interview and Tax Law Application

Bill, 61, and Helen, 62, are married and have lived together for 20 years. Earlier in the interview with Bill, you learned that Helen is too sick to work and needs 24-hour care. Bill is claiming his granddaughter Lucy as a dependent, as noted in the Marital Status and Household Information section of his intake and interview sheet. She is 18 and takes care of Helen. You wonder whether Bill can take the child and dependent care credit.

Apply the questions from the credit for child and dependent care expenses screening sheet in the Volunteer Resource Guide, Tab G, Nonrefundable Credits, to find out whether Bill can take the credit, as shown in the sample interview to follow.

SAMPLE INTERVIEW

VOLUNTEER SAYS...	BILL RESPONDS...
For the credit for child and dependent care, I'd like to ask you some questions about the care provided for your wife, Helen. You may qualify for the credit.	Oh, okay.
Why don't you tell me about your wife's illness and care?	Well, she has chronic lung disease; she can't take care of herself at all. We need to have someone in the home 24 hours a day.
I'm sorry that she is so ill. That must be difficult for both of you. [The volunteer has already determined earlier in the tax return preparation process that Bill has earned income from his full-time teaching job. So he skips these questions in the decision tree and moves ahead to the next relevant question.]	Yes, it is … well, sometimes she has good days, and I'm thankful for that.
Did you pay someone to take care of your wife so that you could go to work?	Yes, I pay my granddaughter Lucy, who just graduated from high school, to take care of Helen.
Oh, I see. Well unfortunately, you won't be able to take the credit for your wife because you are claiming Lucy as a dependent.	Oh, that's okay. Thanks for looking into it for me.
You're welcome. Just trying to help! [On the intake and interview sheet, indicate that the taxpayer doesn't qualify for this credit, and why.]	

Bill does not pass the work-related expenses test because his expenses were paid to a dependent relative.

How do I determine the amount of the credit?

To determine the amount of the credit, multiply the work-related expenses (after applying the earned income and dollar limits) by a percentage. It is possible a qualifying person could have no expenses and a second qualifying person have expenses that exceed $3,000. In that case, list $0 for one person and the actual amount for the second person. The percentage depends on the taxpayer's adjusted gross income.

Tax Software Hint: The tax software performs much of the credit computation for you. To review information related to the software, go to the Volunteer Resource Guide, Tab G, Nonrefundable Credits, Form 2441, Credit for Child and Dependent Care Expenses.

How do I complete Form 2441?

Form 2441 is divided into three parts:

- Part I is for general information about the care provider
- Part II is where the child and dependent care credit is calculated
- Part III is where information is entered if the taxpayer reports employer-provided dependent care benefits

All taxpayers complete Part I first. A checkbox has been added in Part I for taxpayers with a Married Filing Separately filing status that meet the requirement to claim the credit. Taxpayers who did not receive dependent care benefits from their employers then complete Part II. Taxpayers who did receive these benefits complete Part III and then Part II.

What about employer-provided dependent care benefits?

Some taxpayers receive dependent care benefits from their employers. Taxpayers may be able to exclude these benefits from their income. Dependent care benefits include amounts the employer pays either directly to the taxpayer or to the care provider. Employer-provided dependent care benefits appear in the taxpayer's Form W-2, Box 10.

The taxpayer may still be able to claim a child and dependent care credit, but the amount of excluded benefits is not included in work-related expenses and also reduces the dollar limit for the credit. Taxpayers who receive dependent care benefits **must** complete Part III of Form 2441, even if they are not eligible for a child and dependent care credit.

example

Paula has one dependent child, Jenny, who is 6 years old. She paid $2,900 in qualified expenses. Paula's Form W-2, Box 10, shows she received $1,400 during the year from her employer's dependent care assistance program. Because she received dependent care benefits, Form 2441, Part III, must be completed before completing Part II.

Tax Software Hint: To review information related to the software, go to the Volunteer Resource Guide, Tab G, Nonrefundable Credits, Form 2441, Credit for Child and Dependent Care Expenses.

What limits apply to this credit?

The taxpayer's expenses are subject to an earned income limit. The amount of work-related expenses used to figure the credit cannot be more than:

- The taxpayer's earned income for the year or
- If Married Filing Jointly, the smaller of the taxpayer or spouse's earned income for the year

TIP If the taxpayer files a return as a surviving spouse after the death of a spouse during the tax year, the taxpayer may, but is not required to, include the earned income of the spouse who died.

In addition to the earned income limit, there is a dollar limit on the amount of work-related expenses that can be used to figure the credit. This limit is $3,000 for one qualifying person or $6,000 for two or more qualifying persons. If the taxpayer received dependent care benefits from an employer, the amount of the benefits excluded from income must be subtracted from the dollar limit.

example

Mary has three qualifying children. She received $4,800 in dependent care benefits through her employer. When Mary figures her credit, her work-related expenses will be limited to $1,200 ($6,000 – $4,800).

Tax Software Hint: The tax software guides you through applying the limits and computing the credit. If the taxpayer received employer-paid benefits, enter the amounts in the Form W-2 section, and this amount is carried to Part III of Form 2441.

How do I avoid common errors?

When entering information into the software, double-check your entries for the provider's name, ID number, and amounts paid. Be sure that qualified expenses are entered in step 2 of the software. If the taxpayer had an amount in any Form W-2, Box 10, the software will ask you to verify that the entry is correct, and to make sure Form 2441 is completed.

On the intake and interview sheet, make sure the box is checked to indicate that the taxpayer was eligible for the dependent care credit. Note anything unusual that the quality reviewer may need to know when reviewing this part of the tax return.

Summary

The credit for child and dependent care expenses is a nonrefundable credit that allows taxpayers to reduce their tax liability by a portion of the expenses.

The maximum expense amounts are $3,000 for one qualifying person and $6,000 for two or more qualifying persons. This $6,000 limit does not need to be divided equally among them.

The maximum credit rate is 35% of the taxpayer's expenses. A taxpayer must satisfy the five eligibility tests to qualify for the credit. The tests are the:

- Qualifying person test
- Earned income test
- Work-related expense test
- Joint return test
- Provider identification test

The credit is calculated on Form 2441.

What situations are out of scope for the VITA/TCE programs?

The following is out of scope for this lesson. While this list may not be all inclusive, it is provided for your awareness only.

- Taxpayers who need assistance in determining if employment taxes are owed for household employees

TAX LAW APPLICATION

To gain a better understanding of the tax law, complete the practice return(s) for your course of study using the Practice Lab on L&LT.

EXERCISE ANSWERS

Answer 1: *No, they do not qualify.*

Answer 2: *A and D. Audrey is not using the caregiver's services to look for work or to perform work. In addition, both spouses must have earned income during the year to qualify. Only the husband had earned income for the tax year.*