

II. TAX BENEFITS RELATING TO
CHILDRENA. INCREASE AND EXPAND THE CHILD TAX
CREDIT (SEC. 2 OF THE HOUSE BILL, SECS. 201
AND 204 OF THE SENATE AMENDMENT AND
SEC. 24 OF THE CODE)

PRESENT LAW

In general

Under present law, an individual may claim a \$500 tax credit for each qualifying child under the age of 17. In general, a qualifying child is an individual for whom the taxpayer can claim a dependency exemption and who is the taxpayer's son or daughter (or descendent of either), stepson or stepdaughter, or eligible foster child.

The child tax credit is phased-out for individuals with income over certain thresholds. Specifically, the otherwise allowable child tax credit is reduced by \$50 for each \$1,000 (or fraction thereof) of modified adjusted gross income over \$75,000 for single individuals or heads of households, \$110,000 for married individuals filing joint returns, and \$55,000 for married individuals filing separate returns. Modified adjusted gross income is the taxpayer's total gross income plus certain amounts excluded from gross income (i.e., excluded income of U.S. citizens or residents living abroad (sec. 911); residents of Guam, American Samoa, and the Northern Mariana Islands (sec. 931); and residents of Puerto Rico (sec. 933)). The length of the phase-out range depends on the number of qualifying children. For example, the phase-out range for a single individual with one qualifying child is between \$75,000 and \$85,000 of modified adjusted gross income. The phase-out range for a single individual with two qualifying children is between \$75,000 and \$95,000.

The child tax credit is not adjusted annually for inflation.

Refundability

In general, the child tax credit is non-refundable. However, for families with three or more qualifying children, the child tax credit is refundable up to the amount by which the taxpayer's social security taxes exceed the taxpayer's earned income credit.

Alternative minimum tax liability

An individual's alternative minimum tax liability reduces the amount of the refundable earned income credit and, for taxable years beginning after December 31, 2001, the amount of the refundable child credit for families with three or more children. This is known as the alternative minimum tax offset of refundable credits.

Through 2001, an individual generally may reduce his or her tentative alternative minimum tax liability by nonrefundable personal tax credits (such as the \$500 child tax credit and the adoption tax credit). For taxable years beginning after December 31, 2001, nonrefundable personal tax credits may not reduce an individual's income tax liability below his or her tentative alternative minimum tax.

HOUSE BILL

In general

No provision. However, H.R. 6, as passed by the House, contains a provision that increases the child tax credit to \$1,000, phased in over six years, beginning in 2001. Table 10, below, shows the proposed increase in the amount of the child tax credit under the provision.

Table 10.—Increase of the Child Tax Credit

Taxable year	Credit amount per child
2001	\$600
2002	\$600
2003	\$700
2004	\$800
2005	\$900
2006 and thereafter	\$1,000

Refundability

No provision. However, H.R. 6 extends the present-law refundability of the child tax credit to families with fewer than three children.

Alternative minimum tax

No provision. However, H.R. 6 provides that the refundable child tax credit will no longer be reduced by the amount of the alternative minimum tax. In addition, H.R. 6 allows the child tax credit to the extent of the full amount of the individual's regular income tax and alternative minimum tax.

Effective date

No provision. However, the provisions of H.R. 6 generally are effective for taxable years beginning after December 31, 2000.

SENATE AMENDMENT

In general

The Senate amendment increases the child tax credit to \$1,000, phased-in over eleven years, effective for taxable years beginning after December 31, 2000.

Table 11, below, shows the increase of the child tax credit.

Table 11.—Increase of the Child Tax Credit

Calendar year	Credit amount per child
2001–2003	\$600
2004–2006	\$700
2007–2009	\$800
2010	\$900
2011 and later	\$1,000

Refundability

The Senate amendment makes the child credit refundable to the extent of 15 percent of the taxpayer's earned income in excess of

\$10,000.⁹ Thus, in 2001, families with earned income of at least \$14,000 and one child will get a refundable credit of \$600. Families with three or more children are allowed a refundable credit for the amount by which the taxpayer's social security taxes exceed the taxpayer's earned income credit (the present-law rule), if that amount is greater than 15 percent of the taxpayer's earned income in excess of \$10,000. The Senate amendment also provides that the refundable portion of the child credit does not constitute income and shall not be treated as resources for purposes of determining eligibility or the amount or nature of benefits or assistance under any Federal program or any State or local program financed with Federal funds.

Alternative minimum tax

Same as H.R. 6.

Effective date

The provision is effective for taxable years beginning after December 31, 2000.

CONFERENCE AGREEMENT

In general

The conference agreement increases the child tax credit to \$1,000, phased-in over ten years, effective for taxable years beginning after December 31, 2000.

Table 12, below, shows the increase of the child tax credit.

Table 12.—Increase of the Child Tax Credit

Calendar year	Credit amount per child
2001–2004	\$600
2005–2008	\$700
2009	\$800
2010 and later	\$1,000

Refundability

The conference agreement makes the child credit refundable to the extent of 10 percent of the taxpayer's earned income in excess of \$10,000 for calendar years 2001–2004. The percentage is increased to 15 percent for calendar years 2005 and thereafter. The \$10,000 amount is indexed for inflation beginning in 2002. Families with three or more children are allowed a refundable credit for the amount by which the taxpayer's social security taxes exceed the taxpayer's earned income credit (the present-law rule), if that amount is greater than the refundable credit based on the taxpayer's earned income in excess of \$10,000. The conference agreement also provides that the refundable portion of the child credit does not constitute income and shall not be treated as resources for purposes of determining eligibility or the amount or nature of benefits or assistance under any Federal program or any State or local program financed with Federal funds.

Alternative minimum tax

The conference agreement follows H.R. 6 and the Senate amendment.

Effective date

The provision generally is effective for taxable years beginning after December 31, 2000. The provision relating to allowing the child tax credit against alternative minimum tax is effective for taxable years beginning after December 31, 2001.

B. SENSE OF THE SENATE REGARDING CHILD CREDIT EXPANSION (SEC. 202 OF THE SENATE AMENDMENT)

PRESENT LAW

Under present law, an individual may claim a \$500 tax credit for each qualifying child under the age of 17. In general, a qualifying child is an individual for whom the taxpayer can claim a dependency exemption and who is the taxpayer's son or daughter (or

descendent of either), stepson or stepdaughter, or eligible foster child.

HOUSE BILL

No provision.

SENATE AMENDMENT

The Senate amendment provides a Sense of the Senate resolution that the expansion of the child credit included in the Senate amendment be retained in the conference agreement.

CONFERENCE AGREEMENT

The conference agreement does not include the Senate amendment.

C. EXTENSION AND EXPANSION OF ADOPTION TAX BENEFITS (SEC. 2 OF H.R. 622, SEC. 203 OF THE SENATE AMENDMENT, AND SECS. 23 AND 137 OF THE CODE)

PRESENT LAW

Tax credit

In general

A tax credit is allowed for qualified adoption expenses paid or incurred by a taxpayer. The maximum credit is \$5,000 per eligible child (\$6,000 for a special needs child). An eligible child is an individual (1) who has not attained age 18 or (2) is physically or mentally incapable of caring for himself or herself. A special needs child is an eligible child who is a citizen or resident of the United States who a State has determined: (1) cannot or should not be returned to the home of the birth parents; and (2) has a specific factor or condition (such as the child's ethnic background, age, or membership in a minority or sibling group, or the presence of factors such as medical conditions, or physical, mental, or emotional handicaps) because of which the child cannot be placed with adoptive parents without adoption assistance.

Qualified adoption expenses are reasonable and necessary adoption fees, court costs, attorneys fees, and other expenses that are: (1) directly related to, and the principal purpose of which is for, the legal adoption of an eligible child by the taxpayer; (2) not incurred in violation of State or Federal law, or in carrying out any surrogate parenting arrangement; (3) not for the adoption of the child of the taxpayer's spouse; and (4) not reimbursed (e.g., by an employer).

Qualified adoption expenses may be incurred in one or more taxable years, but the credit may not exceed \$5,000 per adoption (\$6,000 for a special needs child). The adoption credit is phased out ratably for taxpayers with modified adjusted gross income between \$75,000 and \$115,000. Modified adjusted gross income is the sum of the taxpayer's adjusted gross income plus amounts excluded from income under Code sections 911, 931, and 933 (relating to the exclusion of income of U.S. citizens or residents living abroad; residents of Guam, American Samoa, and the Northern Mariana Islands; and residents of Puerto Rico, respectively).

The adoption credit for special needs children is permanent. The adoption credit with respect to other children does not apply to expenses paid or incurred after December 31, 2001.

Alternative minimum tax

Through 2001, the adoption credit generally reduces the individual's regular income tax and alternative minimum tax. For taxable years beginning after December 31, 2001, the otherwise allowable adoption credit is allowed only to the extent that the individual's regular income tax liability exceeds the individual's tentative minimum tax, determined without regard to the minimum tax foreign tax credit.

Exclusion from income

A maximum \$5,000 exclusion from the gross income of an employee is allowed for qualified adoption expenses paid or reimbursed by

⁹For these purposes, earned income is defined as under section 32, as amended by this bill.

an employer under an adoption assistance program. The maximum excludible amount is \$6,000 for special needs adoptions. The exclusion is phased out ratably for taxpayers with modified adjusted gross income between \$75,000 and \$115,000. Modified adjusted gross income is the sum of the taxpayer's adjusted gross income plus amounts excluded from income under Code sections 911, 931, and 933 (relating to the exclusion of income of U.S. citizens or residents living abroad; residents of Guam, American Samoa, and the Northern Mariana Islands; and residents of Puerto Rico, respectively). For purposes of this exclusion, modified adjusted gross income also includes all employer payments and reimbursements for adoption expenses whether or not they are taxable to the employee. The exclusion does not apply for purposes of payroll taxes. Adoption expenses paid or reimbursed by the employer under an adoption assistance program are not eligible for the adoption credit. A taxpayer may be eligible for the adoption credit (with respect to qualified adoption expenses he or she incurs) and also for the exclusion (with respect to different qualified adoption expenses paid or reimbursed by his or her employer).

The exclusion from income does not apply to amounts paid or expenses incurred after December 31, 2001.

HOUSE BILL

Tax credit

No provision. However, H.R. 622, the "Hope for Children Act," as passed by the House, permanently extends the adoption credit for children other than special needs children. The maximum credit is increased to \$10,000 per eligible child, including special needs children. The beginning point of the income phase-out range is increased to \$150,000 of modified adjusted gross income. Therefore, the adoption credit is phased-out for taxpayers with modified adjusted gross income of \$190,000 or more. Finally, the adoption credit is allowed against the alternative minimum tax permanently.

Exclusion from income

No provision. However, H.R. 622 permanently extends the exclusion from income for employer-provided adoption assistance. The maximum exclusion is increased to \$10,000 per eligible child, including special needs children. The beginning point of the income phase-out range is increased to \$150,000 of modified adjusted gross income. Therefore, the exclusion is not available to taxpayers with modified adjusted gross income of \$190,000 or more.

Effective date

Generally, the provision of H.R. 622 is effective for taxable years beginning after December 31, 2001. Qualified expenses paid or incurred in taxable years beginning on or before December 31, 2001, remain subject to the present-law dollar limits.

SENATE AMENDMENT

Tax credit

Same as H.R. 622, with one modification. The Senate amendment provides a \$10,000 credit in the year a special needs adoption is finalized regardless of whether the taxpayer has qualified adoption expenses. No credit is allowed with respect to the adoption of a special needs child if the adoption is not finalized.

Exclusion from income

Same as H.R. 622, with one modification. The Senate amendment provides a \$10,000 exclusion in the case of a special needs adoption regardless of whether the taxpayer has qualified adoption expenses.

Effective date

The provision is effective for taxable years beginning after December 31, 2001.

CONFERENCE AGREEMENT

The conference agreement follows the Senate amendment with one modification. The provisions of the Senate amendment that extend the tax credit and exclusion from income for special needs adoptions regardless of whether the taxpayer has qualified adoption expenses are effective for taxable years beginning after December 31, 2002.

D. EXPANSION OF DEPENDENT CARE TAX CREDIT (SEC. 205 OF THE SENATE AMENDMENT AND SEC. 21 OF THE CODE)

PRESENT LAW

Dependent care tax credit

A taxpayer who maintains a household that includes one or more qualifying individuals may claim a nonrefundable credit against income tax liability for up to 30 percent of a limited amount of employment-related expenses. Eligible employment-related expenses are limited to \$2,400 if there is one qualifying individual or \$4,800 if there are two or more qualifying individuals. Thus, the maximum credit is \$720 if there is one qualifying individual and \$1,440 if there are two or more qualifying individuals. The applicable dollar limit (\$2,400/\$4,800) of otherwise eligible employment-related expenses is reduced by any amount excluded from income under an employer-provided dependent care assistance program. For example, a taxpayer with one qualifying individual who has \$2,400 of otherwise eligible employment-related expenses but who excludes \$1,000 of dependent care assistance must reduce the dollar limit of eligible employment-related expenses for the dependent care tax credit by the amount of the exclusion to \$1,400 (\$2,400 - \$1,000 = \$1,400).

A qualifying individual is (1) a dependent of the taxpayer under the age of 13 for whom the taxpayer is eligible to claim a dependency exemption, (2) a dependent of the taxpayer who is physically or mentally incapable of caring for himself or herself, or (3) the spouse of the taxpayer; if the spouse is physically or mentally incapable of caring for himself or herself.

The 30 percent credit rate is reduced, but not below 20 percent, by 1 percentage point for each \$2,000 (or fraction thereof) of adjusted gross income above \$10,000. The credit is not available to married taxpayers unless they file a joint return.

Exclusion from employer-provided dependent care

Amounts paid or incurred by an employer for dependent care assistance provided to an employee generally are excluded from the employee's gross income and wages if the assistance is furnished under a program meeting certain requirements. These requirements include that the program be described in writing, satisfy certain nondiscrimination rules, and provide for notification to all eligible employees. Dependent care assistance expenses eligible for the exclusion are defined the same as employment-related expenses with respect to a qualifying individual under the dependent care tax credit.

The dependent care exclusion is limited to \$5,000 per year, except that a married taxpayer filing a separate return may exclude only \$2,500. Dependent care expenses excluded from income are not eligible for the dependent care tax credit (sec. 21(c)).

HOUSE BILL

No provision.

SENATE AMENDMENT

The Senate amendment increases the maximum amount of eligible employment-related expenses from \$2,400 to \$3,000, if there is one qualifying individual (from \$4,800 to \$6,000, if there are two or more qualifying individuals). The Senate amendment also increases the maximum credit from 30 percent

to 40 percent. Thus, the maximum credit is \$1,200, if there is one qualifying individual and \$2,400, if there are two or more qualifying individuals. Finally, the Senate amendment modifies the phase-down of the credit. Under the Senate amendment, the 40-percent credit rate is reduced, but not below 20 percent, by 1 percentage point for each \$2,000 (or fraction thereof) of adjusted gross income above \$20,000. Therefore, the credit percentage is reduced to 20 percent for taxpayers with adjusted gross income over \$58,000.

Effective date.—The provision is effective for taxable years beginning after December 31, 2001.

CONFERENCE AGREEMENT

The conference agreement follows the Senate amendment, with modifications. Under the conference agreement, the maximum credit is 35 percent. Further, the conference agreement provides that the phase-down of the credit applies with respect to adjusted gross income above \$15,000. Therefore, the credit percentage is reduced to 20 percent for taxpayers with adjusted gross income over \$43,000.

Effective date.—The conference agreement provision is effective for taxable years beginning after December 31, 2002.

E. TAX CREDIT FOR EMPLOYER-PROVIDED CHILD CARE FACILITIES (SECS. 206 AND 207 OF THE SENATE AMENDMENT AND NEW SEC. 45D OF THE CODE)

PRESENT LAW

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

HOUSE BILL

No provision.

SENATE AMENDMENT

Under the Senate amendment, taxpayers receive a tax credit equal to 25 percent of qualified expenses for employee child care and 10 percent of qualified expenses for child care resource and referral services. The maximum total credit that may be claimed by a taxpayer cannot exceed \$150,000 per taxable year.

Qualified child care expenses include costs paid or incurred: (1) to acquire, construct, rehabilitate or expand property that is to be used as part of the taxpayer's qualified child care facility;¹⁰ (2) for the operation of the taxpayer's qualified child care facility, including the costs of training and certain compensation for employees of the child care facility, and scholarship programs; or (3) under a contract with a qualified child care facility to provide child care services to employees of the taxpayer. To be a qualified child care facility, the principal use of the facility must be for child care (unless it is the principal residence of the taxpayer), and the facility must meet all applicable State and local laws and regulations, including any licensing laws. A facility is not treated as a qualified child care facility with respect to a taxpayer unless: (1) it has open enrollment to the employees of the taxpayer; (2) use of the facility (or eligibility to use such facility) does not discriminate in favor of highly compensated employees of the taxpayer (within the meaning of section 414(q)); and (3)

¹⁰ In addition, a depreciation deduction (or amortization in lieu of depreciation) must be allowable with respect to the property and the property must not be part of the principal residence of the taxpayer or any employee of the taxpayer.

at least 30 percent of the children enrolled in the center are dependents of the taxpayer's employees, if the facility is the principal trade or business of the taxpayer. Qualified child care resource and referral expenses are amounts paid or incurred under a contract to provide child care resource and referral services to the employees of the taxpayer. Qualified child care services and qualified child care resource and referral expenditures must be provided (or be eligible for use) in a way that does not discriminate in favor of highly compensated employees of the taxpayer (within the meaning of section 414(q)).

Any amounts for which the taxpayer may otherwise claim a tax deduction are reduced by the amount of these credits. Similarly, if the credits are taken for expenses of acquiring, constructing, rehabilitating, or expanding a facility, the taxpayer's basis in the facility is reduced by the amount of the credits.

Credits taken for the expenses of acquiring, constructing, rehabilitating, or expanding a qualified facility are subject to recapture for the first ten years after the qualified child care facility is placed in service. The amount of recapture is reduced as a percentage of the applicable credit over the ten-year recapture period. Recapture takes effect if the taxpayer either ceases operation of the qualified child care facility or transfers its interest in the qualified child care facility without securing an agreement to assume recapture liability for the transferee. Other rules apply.

Effective date.—The provision is effective for taxable years beginning after December 31, 2001.

CONFERENCE AGREEMENT

The conference agreement follows the Senate amendment.