

Affordable Child Care for Families

Federal & State Tax Incentives

June 2023



Federal Tax Incentives to Promote Affordability for Families:

Dependent Care Tax Credit (DCTC):

The Dependent Care Tax Credit (DCTC) allows families to take a tax credit for child care expenses related to dependent children under age 13 or expenses relating to caring for those individuals who are mentally or physically disabled (and who are claimed as a dependent).

The amount of eligible expenses are capped and only a percentage of the allowable expenses are used to calculate the credit. For example, the credit rate declines as income rises. Allowable child care expenses for a family with one child are limited to \$3,000 per year. Families with two children are allowed \$6,000 in expenses per year. Against the cap of allowable expenses is a percentage limitation that is applied against the cap, which declines as income rises.



Therefore, the maximum credit is \$1,050 for one child (35 percent of \$3,000 in expenses) and \$2,100 for two children (35 percent of \$6,000). The 35 percent credit rate is reduced, but not below 20 percent, by one percentage point for each \$2,000 of adjusted gross income above \$15,000. The credit rate for families with income over \$43,000 is 20 percent.

The following table shows the declining percentage of credit rates by income.

| Income Range | Credit Rate Percentage | Dollar Value for One Child |
|---------------------|------------------------|----------------------------|
| Below \$15,000 | .35 | \$1,050 |
| \$17,000 - \$19,000 | .33 | \$990 |
| \$23,000 - \$25,000 | .30 | \$900 |
| \$27,000 - \$29,000 | .28 | \$840 |
| \$33,000 - \$35,000 | .25 | \$750 |
| \$43,000+ | .20 | \$600 |

To read more information about the DCTC, check out [IRS Form 2441](#) and related [IRS resources](#) that describe how to calculate the credit.

Employer Sponsored Dependent Care Assistance Plans for Child Care Expenses (DCAPs)

Under current federal tax law, employers can set up Dependent Care Assistance Plans, which are flexible spending accounts ([Section 129 of the Internal Revenue Code](#)). If employers choose to offer such plans, employees can set-aside up to \$5,000 in pre-tax salary for dependent care expenses.

Using pre-tax dollars means a tax savings to employees (potentially 20-40 percent of child care expenses depending upon the family's tax bracket and expenses incurred for child care) as well as a tax savings for employers (funds set aside through a flexible spending account reduce employer payroll – for example, these funds aren't subject to FICA or FUTA taxes).

For many employees with young children, they may already be paying for child care, so the option for a flexible spending account reimburses them at a tax savings for money that would be spent anyway.

How do flexible spending plans work? An employer establishes a written plan (required by the IRS) and distributes a summary of the plan to all employees (required by the Department of Labor).

Employees estimate how much they think they will spend on child care for the year. They can then choose to have up to \$5,000 of their salary per year set aside tax-free into a flexible spending account through regular paycheck deductions.

As child care expenses are incurred, employees can submit for reimbursement from their flexible spending account (FSA). FSAs are capped at \$5,000. Expenses related to dependent children under age 13 or related to dependents who are mentally or physically incapable of caring for themselves (and who the employee claims as a dependent) are eligible for reimbursement through FSAs.

Here's [a calculator](#) to help employees figure out tax savings by utilizing DCAP benefits. It's always a good idea to consult with a tax professional, but conceptually, there are savings to be realized through the tax code for employers who wish to assist their employees with child care affordability.

A brief Q&A document related to flexible spending accounts by Horizon Blue Cross Blue Shield of New Jersey is located [here](#). A similar FAQ document related to flexible spending accounts by Rutgers University is located [here](#).

NJ State Tax Credit for Child Care Expenses

Beginning with Tax Year 2021, New Jersey families with children under age 13 (or a dependent who is physically or mentally incapable of self-care) with taxable income of \$150,000 or less are eligible for a tax credit against NJ state income tax.

The amount of the New Jersey credit is a percentage of the taxpayer's federal Child and Dependent Care Tax Credit and varies according to

the amount of the taxpayer's New Jersey taxable income. More information can be found on the New Jersey Division of Taxation web site.

More information related to the CDCTC is located on the [IRS web site](#).

Resource Summary

- [IRS Publication 503](#), Child and Dependent Care Expenses for use in preparing tax returns
- [IRS Instructions to fill out Form 2441](#), Child and Dependent Care Expenses
- [IRS Form 2441](#), Child and Dependent Care Expenses (Tax Credit)
- Dependent Care Assistance Plans (DCAPs), [Section 129 of the Internal Revenue Code](#)
- [New Jersey Child Care Tax Credit](#)

Need help to prepare and file your federal income tax forms?

The [Volunteer Income Tax Assistance \(VITA\) program](#) offers free tax help to people who generally make \$60,000 or less, persons with disabilities and limited English speaking taxpayers who need assistance in preparing their own tax returns. IRS-certified volunteers provide free basic income tax return preparation with electronic filing to qualified individuals.