

Employer Tax Incentives: Expanding the Availability & Affordability of Child Care

December 2022



Child Care Resources

Federal Tax Incentives to Promote Child Care Availability for Employees:

Tax Credits for Employers Providing Child Care and/or Resource and Referral Services to Parents

Businesses can receive a tax credit equal to 25% of qualified expenses for employee child care plus 10% of qualified expenses for child care resource and referral services. The maximum total credit that can be claimed by a business cannot exceed \$150,000 per taxable year. The credit is part of the general business credit and can be claimed any time within 3 years from the due date of the return. ([IRS Form 8882](#))

To be eligible for the credit:

- The primary use of the program must be for child care and the program must meet all applicable state and local laws.
- The child care program must be open to enrollment to the employees of the business.
- Enrollment cannot discriminate in favor of highly compensated employees.
- At least 30 percent of the children enrolled in the program must be dependents of employees of the business.

Qualified child care expenses include costs to:

- Acquire, construct, rehabilitate or expand property that is to be used for the child care program;
- Operate the program, including the costs of training and compensation for employees of the child care program as well as scholarship programs;
- Contract with a qualified program within the community to provide child care to employees of the employer.

Child Care Resource and Referral expenditures:

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 business. Activities must be provided in a way that does not discriminate in favor of highly compensated individuals.



Federal Tax Incentives to Promote Child Care Affordability for Employees:

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. Temporarily through the American Rescue Plan (enacted in March 2021), employees could set aside up to \$10,500 in pre-tax income for 2021 only.

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 paychecks (or temporarily for 2021, \$10,500). As child care expenses are incurred, employees can submit for reimbursement from their flexible spending account (FSA).

Resource Summary:

IRS Form 8882, Employer-provided Child Care Credit
<http://www.irs.gov/pub/irs-pdf/f8882.pdf>

Dependent Care Assistance Plans (DCAPs)
[Section 129 of the Internal Revenue Code](#)

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](#).