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

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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 and 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.

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. 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.

Virginia Employer Child Care Tax Credit

Under § 58.1-439.4, Virginia authorizes a state child care facility investment tax credit.

Employers are allowed a tax credit of up to 25 percent of all expenditures paid or incurred in such taxable year for planning, site preparation, construction, renovation, or acquisition of facilities for the purpose of establishing a child day-care facility to be used primarily by the children of the employer's employees.

The credit may also be used for equipment installed for permanent use within or immediately adjacent to such facility, including kitchen appliances, to the extent that such equipment or appliances are necessary in the use of such facility for purposes of child day-care. However, the amount of credit cannot exceed $25,000. If two or more taxpayers share in the cost of establishing the child day-care facility for the children of their employees, each such taxpayer shall be allowed such credit in relation to the respective share paid or incurred by such taxpayer, of the total expenditures for the facility in such taxable year.

In order to qualify for the tax credit, such facilities must be licensed by the Department of Education. Any tax credit not used for the taxable year may be carried over for the next three taxable years.

The amount of any credit attributable to a partnership, electing small business corporation (S corporation), or limited liability company shall be allocated to the individual partners, shareholders, or members, respectively, in proportion to their ownership or interest in such business entities.

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

Virginia State Employer Tax Credit