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The 45F Tax Credit for Employer-Provided Child Care

Introduction

Many working families across the country struggle to find affordable child care. Employer-provided child care is one model that could align the needs of some working families with the needs of some employers. Families may find that employer-provided care is easier to access, while employers may find that providing child care expands their potential labor force and improves employee recruitment and retention. A Bureau of Labor Statistics survey found that about 13% of civilian workers had access to employer-provided child care in 2024, and that lower-wage workers were less likely to have access than higher-wage workers.

An existing incentive for employers to provide in-kind child care to their employees is the Internal Revenue Code (IRC) Section 45F credit. Available data indicate that the 45F credit is rarely claimed, raising questions about whether the credit is an effective incentive and whether employers view providing child care as a net benefit.

Calculating the 45F Credit

In 2025, the 45F credit allows businesses to reduce their income tax liability by up to \$150,000 per year. The credit is calculated as 25% of *qualified child care expenditures* plus 10% of *qualified child care resource and referral service expenditures* incurred by the business, up to the \$150,000 per year limit.

Qualified child care expenditures subject to the **25% limit** are

- the costs of acquiring, constructing, rehabilitating, or expanding property used as a qualified child care facility;
- the costs of operating a qualified child care facility (including training costs, certain compensation for employees, and scholarship programs); and
- the costs for contracting with a qualified child care facility to provide child care.

Qualified child care resource and referral service expenditures subject to the **10% limit** are

- expenses incurred to help employees find child care services.

A *qualified child care facility* must generally have child care as its principal purpose. The child care facility must also meet all applicable state and local laws and regulations (including being licensed). If the business claiming the credit is itself a child care facility, then at least 30% of the enrollees at the facility must be the employees' dependents. The use of a qualified child care facility and the provision of child care resource and referral services cannot discriminate in favor of highly paid employees.

P.L. 119-21, the FY2025 reconciliation act, scheduled the credit to change in several ways starting in the 2026 tax year. In that year, the maximum credit is to rise to \$500,000 (\$600,000 in the case of an eligible small business; both figures indexed to inflation), and the credit rate for child care expenditures is to rise to 50% (60% in the case of an eligible small business). An "eligible small business" is defined as one whose five-year average gross receipts are below a threshold (\$31 million in 2025; adjusted for inflation). P.L. 119-21 also expanded eligibility, starting in 2026, to include expenses to third-party intermediaries that contract with child care facilities and facilities jointly owned by the taxpayer with others.

Nonrefundable

The 45F credit is nonrefundable, meaning the amount claimed by a business in a given year cannot be greater than the business's income tax liability in that year. However, since the credit is generally claimed as part of the general business credit (IRC Section 38), businesses that cannot claim the full value of the credit in a given year can carry any unused credit amount back 1 year or forward 20 years, offsetting past or future taxes.

Recapture Provision

Any credit claimed for qualifying child care expenditures is recaptured if the qualified child care facility ceases to operate as a qualified child care facility, or for certain ownership transfers within the first 10 years.

Interaction with Business Expense Deduction

Under current law, businesses may be able to deduct as a business expense amounts incurred to provide child care to their employees. For a given amount of child care expenses, the 45F credit generally provides more tax savings than simply deducting child care expenses. Businesses may be able to claim both tax benefits, as shown in the following example.

Assume a business incurs \$700,000 in costs to contract with a qualified child care facility. The business can apply up to \$600,000 of those expenses to the 45F credit since the credit is capped at \$150,000 per year (25% of \$600,000). If the business applies \$600,000 toward the 45F credit, it must reduce the \$700,000 in expenses by the \$150,000 credit when calculating the amount it can claim as a business deduction (\$550,000).

The \$550,000 deduction, if subject to the corporate rate of 21%, would save the business \$115,000 in taxes, which would be in addition to the \$150,000 saved from the credit. That would amount to a total of \$265,000 in tax savings, in comparison to tax savings from the deduction alone of \$147,000 (21% of \$700,000). (Passthrough businesses such

as sole proprietorships and limited liability partnerships, which are generally subject to the individual income tax, could see greater tax savings since the marginal rates faced by individuals can be higher than those faced by corporations.)

Like most credits and deductions, employers generally must incur qualified expenditures before receiving these tax benefits.

Legislative History

The 45F credit was enacted on a temporary basis as part of the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA; P.L. 107-16). It was originally scheduled to expire at the end of 2010, but was extended through the end of 2012 by the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 (P.L. 111-312). The provision was made permanent by the American Taxpayer Relief Act of 2012 (P.L. 112-240). P.L. 119-21 increased the maximum credit and the credit rate for child care expenditures, while making expenses to third-party intermediaries that contract with child care facilities as well as facilities jointly owned by the taxpayer and others eligible, starting in 2026.

Impact

Available data show that very few businesses claim the 45F credit, indicating that the credit has only a minimal impact on encouraging employers to provide child care. For example, GAO estimated that 169 to 278 corporate business returns claimed a total of between \$15.7 million and \$18.8 million in the credit on their 2016 returns. For context, this represents less than 1% of corporate tax returns.

Among businesses that report their business income on their individual owner's income tax returns (i.e., passthroughs), GAO estimated that in 2018, 16,846 to 21,378 individual income tax returns claimed a total of \$6.4 million to \$8.0 million in the 45F credit. For context, this represented about 3% of individual income tax returns that claimed the general business credit. (Note that the number of returns does not indicate number of businesses, since in some cases multiple partners in a business report their portion of the credit separately on their individual income tax returns.) The Joint Committee on Taxation has estimated that the 45F credit will cost a total of \$100 million over the five-year period of FY2022-FY2026 (JCX-22-22).

Interaction with Exclusion for Employer-Sponsored Dependent Care (e.g., Dependent Care FSAs)

The 45F credit can interact with another employer-provided child care tax benefit—the exclusion for employer-sponsored dependent care.

In addition to the 45F credit, employers may provide their employees with up to \$5,000 in tax-free dependent care assistance under IRC Section 129. This benefit is often provided in the form of a flexible spending arrangement (FSA), which is offered to employees as part of a cafeteria plan. Under a cafeteria plan, employees are offered the option to set aside a portion of their salary on a pretax basis for certain qualified expenses, like child and dependent

care. Because these amounts are excluded from an employee's wages, they are subject to neither income taxes nor payroll taxes (i.e., Social Security and Medicare taxes).

For example, assume an employer contracts with a qualified child care facility to provide child care for its 10 employees and directly pays for \$12,000 of each qualified employee's child care expenses at that facility. The employer can both (1) apply \$120,000 to the 45F credit (10 x \$12,000), yielding a credit of \$30,000 and (2) exclude up to \$5,000 of the \$12,000 in expenses from the employees' wages. If an employee were subject to a 22% income tax rate, the exclusion would reduce their taxes by \$1,482.50 (\$1,100 in federal income taxes and \$382.50 in Social Security and Medicare payroll taxes). The amount the employer would have to pay in its share of payroll taxes would also be reduced by \$382.50 per employee. The remaining \$7,000 would be considered part of the employee's compensation and subject to income and payroll taxes. The employee would not be able to participate in a dependent care FSA, since the \$5,000 in expenses that was excluded from their taxable income is the maximum amount that can be excluded under Section 129.

In contrast, if the employer directly paid the child care center \$7,000 per employee and allowed the employee to save \$5,000 in an FSA, the tax benefit from the exclusion would be the same to the employee and employer as discussed above. However, the amount applied toward the 45F would be \$70,000 (10 x \$7,000) and the 45F credit amount would be \$17,500 (25% of \$70,000).

Policy Issues

The limited number of businesses claiming the 45F credit may suggest that the credit has not been broadly adopted by employers to provide child care. Some businesses reported to the Government Accountability Office a number of factors that may limit the credit's effectiveness, including

- substantial start-up and long-term costs to providing child care that the 45F credit does not sufficiently offset;
- difficulties projecting whether enough employees will enroll children to make a child care facility feasible;
- complexity in navigating regulatory and legal issues related to operating a child care facility; and
- a lack of employer awareness of the 45F credit.

Congress may consider addressing these issues if it were to modify the 45F credit. Additionally, policymakers may consider whether employees prefer child care that is tied to their employer. Some evidence suggests that families may favor child care located closer to their homes (rather than near their workplaces) or services such as home-based (rather than care-based) child care. In light of these issues, policymakers may examine whether and to what extent the current credit, or a modified credit, provides a windfall to employers who would have provided child care without the benefit of the 45F credit.

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