Affordable Child Care for Families
Federal Tax Incentives

March 2022

The Children's Movement of Florida

Federal Tax Incentives to Promote Affordability for Families:

Child and Dependent Care Tax Credit (CDCTC):

The Dependent Care Tax Credit (DCTC) is an opportunity for 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.

For the past 20 years, allowable child care expenses for a family with one child have been limited to $3,000 per year. Families with two children have been limited to $6,000 in expenses per year. **Temporarily for 2021,** *(child care expenses incurred in 2021 for which taxpayers file tax returns in the spring of 2022)*, **the expense caps have been increased to $8,000 for families with one child and $16,000 for families with two children.**

Against the cap of allowable expenses is a percentage limitation that is applied against the cap, which declines as income rises.

Therefore, temporarily for child care expenses in 2021, the maximum tax credit for child care expenses is $4,000 for one child (50% of the $8,000 expense cap) and $8,000 for two children (50% of the $16,000 expense cap).

The tax credit starts to phase out for taxpayers with adjusted gross income above $125,000 (e.g., the 50% credit declines to 49% for families with income of $125,000 - $127,000; 48% for families with income of $127,000 - $129,000; 47% for families with income of $129,000 - $131,000, etc.).

The increased value of the credit expires after December 31, 2021. This means that child care expenses paid in 2022 (for which taxpayers file tax returns in the spring of 2023) will revert back to a maximum credit of $1,050 for one child (35 percent of $3,000 in expenses) and $2,100 for two children (35 percent of $6,000). The credit rate for families with income over $43,000 will return to 20 percent (unless the current more generous rules are extended by Congress).

Internal Revenue Service (IRS) guidance for taxable year 2021 (related to the American Rescue Plan Act temporary 1 year increase) is located on the IRS web site.

To read more information about the CDCTC, check out IRS FAQS, Form 2441 and related instructions and IRS publication 503 (Child and Dependent Care Expenses).

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. (The American Rescue plan temporarily increased the amount employees can set aside to $10,500 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 paycheck deductions (or $10,500 in 2021).

As child care expenses are incurred, employees can submit for reimbursement from their flexible spending account (FSA). 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. You can read more about flexible spending accounts through Florida's FSA web page.

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 $55,000 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.

https://www.irs.gov/individuals/free-tax-return-preparation-for-you-by-volunteers

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