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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. Despite the potential advantages of employer-provided care, a Bureau of Labor Statistics survey found that about 11% of civilian workers had access to employer-provided child care in 2021 and that lower-wage workers were less likely to have access than higher-wage workers. (Bureau of Labor Statistics, National Compensation Survey: Employee Benefits in the United States, March 2021, Table 41.)

Policymakers may be interested in tax policy options that incentivize businesses to provide child care for their employees. One existing option 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
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.

To be eligible for the credit, 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.

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.

Nonrefundability
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=$150,000). 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.)