



February 2022

# EMPLOYER- PROVIDED CHILD CARE CREDIT

## Estimated Claims and Factors Limiting Wider Use

Accessible Version

# GAO Highlight

Highlights of [GAO-22-105264](#), a report to congressional committees

## Why GAO Did This Study

Child care is essential for allowing many adults to engage in the workforce but concerns about family access to child care have increased after many child care centers and family child care programs closed during the COVID-19 pandemic. Established in 2001, the Employer-Provided Child Care Credit can provide a tax incentive for employers to provide child care benefits.

House Committee Report 116-456 included a provision for GAO to review the credit. For this report, GAO examines (1) the tax implications for employer-provided child care for employers and employees, (2) the numbers and common characteristics of employers claiming the credit, and the amounts of child care expenses claimed, (3) reported challenges employers face in using the tax credit and how these challenges can be addressed, and (4) reported benefits employees receive from child care services eligible for the credit.

To do so, GAO reviewed IRS documents on the tax treatment of fringe benefits; reviewed IRS estimates of filers claiming the credit and amounts claimed; interviewed IRS and Department of the Treasury officials; and reviewed literature and relevant federal laws and regulations. GAO also interviewed eight groups selected to obtain diverse views on employer, worker/family, and child care issues. They were identified through literature review and referrals by interviewees.

View [GAO-22-105264](#). For more information, contact Kathryn A. Larin at (202) 512-7215 or [larink@gao.gov](mailto:larink@gao.gov), or James R. McTigue, Jr. at (202) 512-6806 or [mctiguej@gao.gov](mailto:mctiguej@gao.gov).

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## EMPLOYER-PROVIDED CHILD CARE CREDIT

### Estimated Claims and Factors Limiting Wider Use

## What GAO Found

The Employer-Provided Child Care Credit can save employers with eligible expenses (see figure) more in taxes than using a deduction alone, and employees can exclude some child care benefits from their taxable wages. For employers, the credit can offset actual federal income tax liability. Employers may also deduct child care expenses. To avoid duplication, the total amount deductible must be reduced by amounts claimed for the credit. For employees, certain child care benefits can be excluded from their wages, up to \$5,000. If an employee's expenses exceed the exclusion limit, they may be eligible to claim the Child and Dependent Care Credit, but not for the same expenses.

### Employers' Eligible Expenses under the Employer-Provided Child Care Credit

25% of total expenditures



Source: GAO analysis of 26 U.S.C. § 45F and NTL studio/olgache/stock.adobe.com. | GAO-22-105264

In 2016, the most recent complete year available, the Internal Revenue Service estimated 169 to 278 corporate income tax returns claimed an aggregate estimated \$15.7 to \$18.8 million in Employer-Provided Child Care credits. In 2018, the most recent year available, IRS estimated corporate returns reported \$144.7 to \$154.8 million in qualified child care facility expenses, and fewer child care resource and referral expenses. In 2013, the last year available, manufacturing, finance and insurance, and information industries accounted for about half of the aggregate amounts of the credit claimed.

Selected groups that review employers, workers and families, and child care issues told GAO several factors limit employers' use of the credit. For example, several groups said that building and operating on-site child care entails substantial costs, and planning and administering on-site child care can be complex. These groups also said employers are often unaware of the credit and that it may be too small, in relation to the costs, to sufficiently incentivize employers to provide child care. These groups suggested increasing outreach and education and redesigning the credit. For example, some groups suggested increasing the portion of expenses that can be offset and the maximum allowable credit. Other groups said changes to the credit may not increase use, and that employee interest in on-site child care may decrease if remote work becomes more common. In addition, credit changes could result in increased federal costs.

Groups GAO interviewed also described various benefits of the employer-provided child care services eligible for the credit, such as employees' increased productivity and engagement. However, some noted that such services may not be accessible to all employees, such as shift workers, and may not be affordable even when employer-subsidized.

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**Abbreviations**

ARPA	American Rescue Plan Act of 2021
CDCC	Child and Dependent Care Credit
DCAP	dependent care assistance program
FICA	Federal Insurance Contributions Act
FSA	flexible spending arrangement
IRC	Internal Revenue Code
SOI	Statistics of Income

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February 24, 2022

Congressional Committees

Child care is one of the largest expenses for many American working families. Concerns about family access to child care have increased after many child care centers and family child care programs closed during the Coronavirus Disease 2019 (COVID-19) pandemic. Additionally, operating expenses for those providers that have remained open during the pandemic have increased due to costs related to personal protective equipment, sanitation supplies, and reduced enrollment limits to meet state and local social distancing requirements. As local economies begin to expand work opportunities and people seek employment, many families may face increased challenges with finding affordable child care. Established in 2001, the Employer-Provided Child Care Credit can provide a tax incentive for employers to provide on-site child care facilities.<sup>1</sup> However, federal data suggest that far fewer employers have used the credit than originally projected.

House Committee Report 116-456 included a provision for GAO to review the Employer-Provided Child Care Credit.<sup>2</sup> For this report, we examine (1) the tax implications of employer-provided child care for both employers and employees, (2) the numbers and common characteristics of employers claiming the credit, and the amounts of child care expenditures claimed, (3) reported challenges employers face in using the credit and how these challenges can be addressed, and (4) reported benefits employees receive from child care services eligible for the credit.

To examine the tax implications for employers providing and employees receiving child care, we reviewed federal laws and Internal Revenue Service documentation on the credit—including the Form 8882, *Credit for Employer-Provided Child Care Facilities and Services* and instructions—as well as IRS publications and documentation on the treatment of fringe benefits for income and employment tax.<sup>3</sup> We interviewed officials from

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<sup>1</sup>26 U.S.C. § 45F.

<sup>2</sup>H.R. Rep. No. 116-456, at 25 (2020).

<sup>3</sup>A fringe benefit is a form of pay for the performance of services, for example, when an employer provides an employee with child care assistance.

IRS and the Department of the Treasury about the credit and the tax treatment of employees receiving employer-provided child care.

To determine the numbers and common characteristics of employers claiming the child care credit, and the amounts of expenditures claimed, we reviewed IRS Statistics of Income (SOI) publicly available estimates for corporate and individual income tax returns claiming the credit. For both individual and corporate income tax returns, we reviewed estimated counts and amounts of child care credits claimed on Form 3800, *General Business Credit*, for tax years beginning 2003 and 2008, respectively, to 2018—the most recent year available at the time of our analysis.<sup>4</sup> We also reviewed estimated corporate credit amounts claimed on Form 3800 by major industry sector for tax year 2013, the latest year available by industry.<sup>5</sup>

For information about the types and amounts of child care expenditures claimed, we reviewed estimates from Form 8882 for tax years 2008 to 2018.<sup>6</sup> SOI Form 8882 estimates were available only for corporate income tax returns and not for other employers, such as partnership tax returns or sole proprietor businesses filing individual income tax returns.<sup>7</sup> We assessed the reliability of the estimates by reviewing SOI documentation of quality control steps and interviewing IRS officials familiar with the data. IRS calculated 95 percent confidence intervals related to each estimate.

However, the SOI sample may not provide a precise estimate of the number of returns or other quantities when the number of returns in a particular reporting group is very small.<sup>8</sup> For years prior to 2013, publicly-

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<sup>4</sup>Internal Revenue Service, Statistics of Income, Corporation Income Tax Returns, Line Item Estimates, (Washington, D.C.); and Internal Revenue Service, Statistics of Income, Individual Income Tax Returns, Line Item Estimates(Washington, D.C.). Data compiled by IRS Statistics of Income are based on a stratified random sample of tax returns.

<sup>5</sup>Internal Revenue Service, Statistics of Income—2013, Corporation Income Tax Returns (Washington, D.C.).

<sup>6</sup>For any given taxpayer, the credit amount calculated on the Form 8882 may not be the same as the credit amount claimed on Form 3800.

<sup>7</sup>Not all corporate taxpayers are required to file a Form 8882. Only credit amounts claimed by partnerships, S corporations, estates, and trusts must be reported on Form 8882. Some corporate and individual taxpayers claim their portion of credits passed through from partnerships, for example, directly on the Form 3800.

<sup>8</sup>The SOI sample design does not include the Employer-Provided Child Care Credit as a criterion for how stratified samples are selected.

available estimates based on the small number of returns claiming the credit may have had large relative margins of error. For this reason, we report only the confidence intervals. We determined that the confidence intervals for the estimates from 2013 to 2018 were sufficiently reliable for our reporting purposes.

To identify reported challenges employers face in using the credit, how the challenges can be addressed, and the reported benefits employees receive from child care services eligible for the credit, we conducted a literature review to identify and compile information on the credit. We also interviewed a nongeneralizable sample of eight groups that focus on employer, worker/family, child care and public policy issues. We identified these groups through a combination of methods, including reviewing publications on the topic and asking interviewees to identify other individuals and organizations with knowledge about the credit. Additionally, we interviewed IRS and Treasury officials about potential challenges employers face in using the credit and the benefits to employees when employers provide child care services eligible for the credit. We reviewed relevant federal laws and regulations. The information we present for these objectives is based on statements and materials from the selected groups we interviewed. We did not conduct an independent assessment of the feasibility of their proposed options.

We conducted this performance audit from May 2021 to February 2022 in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

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## Background

Many adults require child care to participate in the workforce. Specifically, in 2020, both parents in over half of all families with children under the age of 6 were employed, and over two-thirds of single parents with young children were employed.<sup>9</sup> Provider shortages have sharply reduced the

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<sup>9</sup>Department of Labor, Bureau of Labor Statistics, *Families with own children: Employment status of parents by age of youngest child and family type, 2019-2020 annual averages*, accessed Nov. 23, 2021, <https://www.bls.gov/news.release/famee.t04.htm>.

supply of child care services during the pandemic, posing hardships on many families and parents. As of November 2021, there were about 1.4 million fewer women in the labor force than at the beginning of the pandemic in February 2020, according to the Bureau of Labor Statistics.<sup>10</sup> Some research has attributed this reduction to limited access to or availability of child care services during the pandemic, among other factors.<sup>11</sup> Child care remains infrequently offered by employers. About 11 percent of all workers had access to employer-provided child care, and those with lower incomes were less likely to have access, according to 2021 analysis from the Bureau of Labor Statistics.<sup>12</sup>

The Employer-Provided Child Care Credit was included as a provision of the Economic Growth and Tax Relief Reconciliation Act of 2001 and was designed to encourage employers to provide their employees with child care services.<sup>13</sup> It was made permanent by the American Taxpayer Relief Act of 2012.<sup>14</sup> Historically, claims of the credit have been far below original federal estimates, with an estimated \$20 million in forgone tax

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<sup>10</sup>Department of Labor, Bureau of Labor Statistics, *Current Population Survey: Labor Force Statistics*, accessed October 26, 2021, <https://www.bls.gov/webapps/legacy/cpsatab1.htm>. Data are seasonally adjusted and based on the population of women age 20 years and over.

<sup>11</sup>For example, see Simeon Djankov, Pinelopi Koujianou Goldberg, Marie Hyland and Eva (Yiwen) Zhang, “COVID-19 Widens the Gender Gap in Labor Force Participation,” (Peterson Institute for International Economics, Mar. 8, 2021), accessed Dec. 7, 2021, <https://www.piie.com/blogs/realtime-economic-issues-watch/covid-19-widens-gender-gap-labor-force-participation>; and ReadyNation, *Female Labor Force Participation Is Key to Our Economic Recovery* (Washington, D.C.: July 2021), accessed Dec. 7, 2021, <https://www.strongnation.org/articles/1604-female-labor-force-participation-is-key-to-our-economic-recovery>.

<sup>12</sup>Department of Labor, Bureau of Labor Statistics, *National Compensation Survey: Employee Benefits in the United States, March 2021* (Washington, D.C.: September 2021). The BLS report defines employer-provided child care as a “workplace program that provides for either the full or partial cost of caring for an employee’s children in a nursery, day care center, or a babysitter in facilities either on or off the employer’s premises.”

<sup>13</sup>Pub. L. No. 107-16, § 205, 115 Stat. 38, 50–53, *codified at* 26 U.S.C. § 45F.

<sup>14</sup>Pub. L. No. 112-240, § 101(a)(1), 126 Stat. 2313, 2315 (2013). When the credit was made permanent, the Joint Committee on Taxation estimated that employers would claim about \$209 million in the credit from 2013 to 2022. See Joint Committee on Taxation, *Estimated Revenue Effects of the Revenue Provisions Contained in an Amendment in the Nature of a Substitute to H.R. 8, The “American Taxpayer Relief Act of 2012,” as Passed by the Senate on January 1, 2013*, JCX-1-13 (Washington, D.C.: Jan. 1, 2013).



revenue for fiscal year 2020.<sup>15</sup> Given this, the tax credit is among the smaller federal contributions to supporting early learning and child care. Comparatively, for same fiscal year federal agencies spent about \$11.5 billion on Head Start and \$9.3 billion on the Child Care and Development Block Grant.<sup>16</sup>

The tax credit is equal to the sum of 25 percent of qualified child care expenditures, and 10 percent of qualified child care resource and referral service expenditures, with a total taxable year limit of \$150,000.<sup>17</sup> Employers may claim the credit if they incur qualified expenses (1) to acquire, construct, rehabilitate, or expand and operate a qualified child care facility of the taxpayer; (2) under a contract with a qualified child care facility to provide child care services to employees of the taxpayer; or (3) under a contract to provide resource and referral services to an employee of the taxpayer (see fig. 1).

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<sup>15</sup>Office of Management and Budget, *Analytical Perspectives, Budget of the United States Government, Fiscal Year 2022* (Washington, D.C.: 2021). In 2001, the Joint Committee on Taxation estimated that employers would claim about \$1.4 billion in the credit from 2002 to 2011. See Joint Committee on Taxation, *Estimated Budget Effects of the Conference Agreement for H.R. 1836*, JCX-51-01 (Washington, D.C.: May 26, 2001).

<sup>16</sup>Additionally, the Child Care and Development Block Grant and Head Start both prioritize expanding access to child care and early education for low-income families. These figures above represent obligated funds. The fiscal year 2020 amount of the Child Care and Development Block Grant includes obligated supplemental funds through the CARES Act.

<sup>17</sup>26 U.S.C. § 45F(a), (b). For purposes of this credit, all persons treated as a single employer are treated as a single taxpayer. In general, partnerships, corporations, unincorporated businesses, and other persons under common control are treated as a single employer. 26 U.S.C. §§ 45F(e)(1), 52(a), (b). Therefore, the credit's limit applies in aggregation to these entities.

**Figure 1: Employers' Eligible Expenses under the Employer-Provided Child Care Credit**



Source: GAO analysis of 26 U.S.C. § 45F and NTL studio/olgache/stock.adobe.com. | GAO-22-105264

<sup>a</sup>The operating expenses of a qualified child care facility include costs related to the training of employees, to scholarship programs, and to the providing of increased compensation to employees with higher levels of child care training.

<sup>b</sup>In general, a qualified child care facility must meet the requirements of all applicable laws and regulations of the state or local government in which it is located, including the licensing of the facility as a child care facility. In addition, the principal use of the facility must be to provide child care assistance.

For an employer's child care facility to qualify, the use of the facility cannot discriminate in favor of highly compensated employees.<sup>18</sup> In addition, if the employer is a child care provider, at least 30 percent of the enrollees of the child care facility must be dependents of the employees.<sup>19</sup>

<sup>18</sup>26 U.S.C. § 45F(c)(2)(B). For 2021, a highly compensated employee is an employee who (1) was a 5-percent owner at any time during the year or the preceding year or (2) received more than \$130,000 in pay for the preceding year or was in the top 20 percent of employees based on compensation in the preceding year.

<sup>19</sup>Enrollment in the facility must be open to employees during the taxable year.

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## The Employer-Provided Child Care Credit Can Reduce Taxes for Employers, and Employees Can Exclude Some Child Care Benefits from Taxable Income

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### Employers Providing Qualified Child Care Can Reduce Taxes Using the Credit and Deducting Remaining Expenses

The Employer-Provided Child Care Credit, coupled with a business expense deduction, can result in more tax savings for employers than with a deduction alone. Generally, employers can deduct the costs of providing child care for their employees as a trade or business expense.<sup>20</sup> Employers with qualified child care expenses can also opt to claim the credit and deduct a portion of their child care costs as business expenses. The credit, which is generally reported as part of the general business credit, can offset actual federal income tax liability and is not refundable in the current tax year. In general, the unused credit may be carried back 1 year or forward up to 20 years.<sup>21</sup> Credit amounts claimed by partnerships and S corporations are to be passed through to their partners and shareholders, respectively, who may claim their portions of the credit on their individual income tax returns.<sup>22</sup> To avoid duplication, the total amount of child care expenses that can be deducted as a trade or business expense must be reduced by any amount claimed for the credit. Tables 1 and 2 illustrate how an employer can save more in taxes by claiming the credit and deducting remaining expenses than by taking a deduction alone for child care expenses that qualify.

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<sup>20</sup>Business expenses are the costs of carrying on a trade or business, and they are usually deductible if the business is operated to make a profit. To be deductible, a business expense must be both ordinary and necessary. An ordinary expense is one that is common and accepted in the employer's industry. A necessary expense is one that is helpful and appropriate for the employer's trade or business.

<sup>21</sup>26 U.S.C. §§ 39(a)(1), 45F(d)(4).

<sup>22</sup>Owners of S corporations are referred to as shareholders. S corporations are corporations that "pass through" gains and losses to shareholders' individual tax returns without generally paying taxes at the entity level. Similarly, partners receive pass-through income and losses from a partnership, and partnerships do not pay tax at the entity level.

**Table 1: Example of Tax Effect for Employer with Qualifying Child Care Facility Expenditures**

	<b>Employer-Provided Child Care Credit (taken with Business Expense Deduction)</b>	<b>Business Expense Deduction Only (taken without credit)</b>
One-time expense associated with acquiring, constructing, rehabilitating, or expanding property to be used as part of a qualified child care facility	\$1,000,000	\$1,000,000
Employer-Provided Child Care Credit rate for facility expenditures	25 percent	N/A
Tax Credit (25 percent rate applied)	\$250,000	N/A
Actual Employer-Provided Child Care Credit claimed (limit of \$150,000 per tax year)	\$150,000	N/A
Expenses without regard to credit	\$1,000,000	\$1,000,000
Less actual Employer-Provided Child Care Credit claimed	\$150,000	N/A
Amount deductible for federal income tax purposes (after credit)	\$850,000	\$1,000,000
Corporate tax rate	21 percent	21 percent
Business expense tax deduction (21 percent rate applied)	\$178,500	\$210,000
<b>Total tax benefit (child care credit claim plus deduction)</b>	<b>\$328,500</b>	<b>\$210,000</b>
<b>After-tax cost to employer (original expenses less total tax benefit)</b>	<b>\$671,500</b>	<b>\$790,000</b>

Source: GAO analysis of IRS instructions and publications. | GAO-22-105264

Note: For the purpose of this illustrative example, we assume the construction costs for a child care facility are incurred over one year. Capital expenditures of a qualified child care facility are depreciable property, meaning such costs are recovered through depreciation over the life of the qualified child care facility asset(s) rather than all at once.

**Table 2: Example of Tax Effect for Employer with Qualifying Child Care Resource and Referral Expenditures**

	<b>Employer-Provided Child Care Credit (taken with Business Expense Deduction)</b>	<b>Business Expense Deduction Only (taken without credit)</b>
Annual expenses paid or incurred under a contract to provide child care resource and referral services to employees	\$235,000	\$235,000
Employer-Provided Child Care Credit rate for resource and referral expenditures	10 percent	N/A
Tax Credit (10 percent rate applied)	\$23,500	N/A
Actual Employer-Provided Child Care Credit claimed (limit of \$150,000 per tax year)	\$23,500	N/A
Annual expenses without regard to credit	\$235,000	\$235,000
Less actual Employer-Provided Child Care Credit claimed	\$23,500	N/A
Amount deductible for federal income tax purposes	\$211,500	\$235,000
Corporate tax rate	21 percent	21 percent
Business expense tax deduction (21 percent rate applied)	\$44,415	\$49,350
<b>Total tax benefit (child care credit claim plus deduction)</b>	<b>\$67,915</b>	<b>\$49,350</b>
<b>After-tax cost to employer (original expenses less total tax benefit)</b>	<b>\$167,085</b>	<b>\$185,650</b>

Source: GAO analysis of IRS instructions and publications. | GAO-22-105264

Some qualified child care expenses under the credit, such as the fair market value of care in an employer-provided or -sponsored child care facility, may also be eligible for the dependent care exclusion.<sup>23</sup> Employers that establish dependent care assistance programs (DCAP) may exclude dependent care assistance provided up to the employee exclusion limit, resulting in additional employer savings in Social Security and Medicare employment taxes as well as federal unemployment taxes.<sup>24</sup> An employer must establish a separate written plan for the

<sup>23</sup>26 U.S.C. § 129. If an employer does not charge employees for enrollment in a child care facility operated by the employer or for child care services provided under a contract with a qualified child care facility, the fair market value of the care up to the annual limit is eligible for exclusion under Internal Revenue Code (IRC) Section 129. If the employee is charged and pays the fair market value for the employer-provided child care, there is no taxable income for exclusion.

<sup>24</sup>A dependent care assistance program is a separate written plan of an employer for the exclusive benefit of their employees to provide such employees with dependent care assistance. Exclusions are those items of income that would otherwise constitute a part of the taxpayer's gross income, but are excluded under a specific provision of the tax code.

**Increase in Exclusion for Dependent Care Assistance and the Child and Dependent Care Credit**

The American Rescue Plan Act of 2021 (ARPA) temporarily expanded the exclusion for dependent care assistance programs (DCAP) and the Child and Dependent Care Credit (CDCC) for the 2021 tax year.

- **Exclusion:** Section 9632 of ARPA increased the maximum amount of qualifying dependent care expenses that eligible taxpayers can exclude from their income under a DCAP from \$5,000 (or \$2,500 for married individuals filing separately) to \$10,500 (or \$5,250).
- **CDCC:** Section 9631 of ARPA expanded the credit by making it refundable for taxpayers with a principal place of abode in the United States for at least half of the year, and by increasing the cap on qualifying employment-related expenses from \$3,000 for one qualifying person and \$6,000 for two or more qualifying persons to \$8,000 and \$16,000, respectively.

ARPA also increased the applicable percentage to 50 percent of qualified employment-related expenses, compared to 35 percent in prior years. The phase out for the applicable percentage starts at \$125,000 and the credit itself is completely phased out at \$438,000.

Source: GAO analysis of legislation and IRS guidance. | GAO-22-105264

assistance to fall under the employee exclusion.<sup>25</sup> Other dependent care benefits eligible for the exclusion, such as direct payment from an employer to an employee or the employee’s child-care provider for the care of a qualifying person and pre-tax employee contributions made under a dependent care flexible spending arrangement (FSA), are not eligible expenses for purposes of the Employer-Provided Child Care Credit.<sup>26</sup> Employers are instructed to report the value of all dependent care assistance provided to an employee under a DCAP on the employee’s Form W-2, including both the nontaxable portion of assistance (up to \$5,000) and any assistance above that amount that is taxable to the employee.<sup>27</sup>

**Employees Receiving Employer-Provided Child Care under a DCAP Can Generally Exclude Benefits from Taxable Income**

Employees receiving employer-provided child and dependent care benefits under a DCAP can generally exclude from their taxable wages up to \$5,000 (or \$2,500 for married employees filing separate returns)

<sup>25</sup>Employers may exclude the value of dependent care benefits provided to an employee under a DCAP from the employee’s wages for purposes of Federal Insurance Contributions Act (FICA) and income tax withholding if the employer reasonably believes that the employee can exclude the benefits from gross income under IRC Section 129. Employers cannot exclude dependent care assistance from the wages of a highly compensated employee unless the benefits provided under the program do not favor highly compensated employees and the program meets the requirements described in IRC Section 129(d).

<sup>26</sup>According to Treasury officials, DCAPs are more commonly provided through dependent care FSAs funded by employee’s pre-tax salary reduction contributions, as opposed to employer-provided amounts in excess of employee earnings.

<sup>27</sup>IRS Publication 15-B, *Employer’s Tax Guide to Fringe Benefits*, contains information for employers on the employment tax treatment of fringe benefits, including dependent care assistance.

and thus owe less in income and employment taxes.<sup>28</sup> Any amount of benefits that exceeds the applicable limit is taxable income. Like other exclusions, the dependent care benefit exclusion provides more assistance to taxpayers with high marginal tax rates (generally those with high incomes) because it saves those taxpayers more in income taxes owed than it saves those with lower marginal tax rates.

If an employee has employment-related expenses for the care of one or more qualifying persons that exceed the \$5,000 dependent care exclusion limit (or a lesser amount that the employee has otherwise elected under a dependent care FSA, if applicable), they may also qualify for a Child and Dependent Care Credit (CDCC).<sup>29</sup> An employee can claim both the exclusion and the CDCC, but not for the same expenses. For every dollar excluded from the employee's income, the employee must reduce the maximum amount of qualifying expenses claimed for the CDCC. Table 3 illustrates the resulting tax implications for employees receiving employer-provided or -sponsored child care assistance.

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**Table 3: Scenarios of Tax Implications for Employees Receiving Employer-Provided or -Sponsored Child Care Assistance**

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Employer X does not provide child care, but offers a dependent care flexible spending arrangement (FSA).	<ul style="list-style-type: none"><li data-bbox="438 1102 1536 1228">• If the employee elects to participate in the dependent care FSA to pay for some or all of the child care expenses, the employee can exclude from gross income up to \$5,000 of the FSA benefit received. Any amount of this assistance in excess of the exclusion is reported as taxable income.</li><li data-bbox="438 1228 1536 1375">• If an employee still pays an amount that exceeds the employee's dependent care FSA election, the employee may still be able to claim the Child and Dependent Care Credit (CDCC) for those expenses. An employee can take both the exclusion and the CDCC, but not for the same expenses. For every dollar excluded from the employee's income, the employee must reduce the maximum amount of qualifying expenses claimed for the CDCC.</li></ul>
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<sup>28</sup>The exclusion applies to dependent care services an employer directly or indirectly pays for and provides to an employee under a DCAP that covers only its employees. The services must be for a qualifying person's care and must be provided to allow the employee to work.

<sup>29</sup>26 U.S.C. § 21(a). A qualifying individual for the CDCC and the exclusion is: a dependent qualifying child who was under age 13 when the care was provided; a spouse who was physically or mentally incapable of self-care and lived with the taxpayer for more than half of the year; or an individual who was physically or mentally incapable of self-care, lived with the taxpayer for more than half of the year, and either: (a) was the taxpayer's dependent; or (b) could have been the taxpayer's dependent except that the individual received gross income of \$4,300 or more, or filed a joint return, or the taxpayer (or the taxpayer's spouse, if filing jointly) could have been claimed as a dependent on another taxpayer's return. 26 U.S.C. §§ 21(b)(1), 152.

Employer Y provides the employee a discount for child care provided.	<ul style="list-style-type: none"> <li>If the discount is provided under a written dependent care assistance program (DCAP) it is considered taxable income. The employee can generally exclude from gross income up to \$5,000 of the benefit received. Any amount of this assistance in excess of the exclusion is reported as taxable income.</li> <li>If an employee still pays for some of the employer-provided child care, the employee may still be able to claim the CDCC for those expenses. An employee can take both the exclusion and the CDCC, but not for the same expenses. For every dollar excluded from the employee's income, the employee must reduce the maximum amount of qualifying expenses claimed for the CDCC.</li> </ul>
Employer Z charges the employee the fair market value for child care provided.	<ul style="list-style-type: none"> <li>If the employee is charged and pays the fair market value for care provided, there is no taxable income for exclusion.</li> <li>The employee may be eligible to claim the CDCC for the fair market value of care provided that the employee pays.</li> </ul>

Source: GAO analysis of IRS documentation of the treatment of fringe benefits for income and employment tax. | GAO-22-105264

Note: The American Rescue Plan Act of 2021 (ARPA) temporarily increased the maximum amount of dependent care expenses that eligible taxpayers can exclude from their income under a DCAP from \$5,000 to \$10,500 for tax year 2021. ARPA also increased the cap on qualifying employment-related expenses for the CDCC from \$3,000 for one qualifying individual and \$6,000 for two or more qualifying individuals to \$8,000 and \$16,000, respectively.

## Corporate Employers Claimed the Largest Aggregate Amounts of the Credit, Mainly for Child Care Facility Expenses

In 2016, the most recent complete year available, IRS estimated 169 to 278 corporate income tax returns claimed an aggregate estimated \$15,727,000 to \$18,829,000 in child care credits on Form 3800 (see table 4).<sup>30</sup> For perspective on the relatively small number of corporations using the credit, an estimated 70,001 to 78,808 corporate income tax returns filed a Form 3800 in 2016.

**Table 4: Estimated Range of the Number of Corporate Returns Claiming the Employer-Provided Child Care Credit and Total Amount Claimed, 2013-2016**

Year	Counts		Amounts (in dollars)	
	Lower bound	Upper bound	Lower bound	Upper bound
2013	194	268	15,785,000	17,749,000
2014	185	258	14,957,000	17,032,000
2015	163	249	15,366,000	17,500,000

<sup>30</sup>Child care credit amounts on Form 3800 do not necessarily result in dollar-for-dollar tax reductions in the year. If an employer does not have sufficient federal income tax liability in a given tax year to fully use the credit, the unused credit amount may be carried back 1 year or forward up to 20 years.



Year	Counts		Amounts (in dollars)	
	Lower bound	Upper bound	Lower bound	Upper bound
2016	169	278	15,727,000	18,829,000

Source: GAO analysis of IRS Statistics of Income. | GAO-22-105264

Notes: Lower and upper bound estimates are the 95 percent confidence interval. IRS suppressed 2017 and 2018 estimates to avoid disclosure of information for specific corporations. Data are from IRS Form 3800.

In 2013, the latest year for which data are available, three industry sectors accounted for about half of the estimated aggregate amounts of the child care credit on Form 3800.<sup>31</sup> These industry sectors were (1) manufacturing, (2) finance and insurance, and (3) information (see table 5).

**Table 5: Estimated Range of Amounts Claimed for the Employer-Provided Child Care Credit by Corporate Filers, by Industry, 2013**

In dollars

Industry	Lower bound	Upper bound
All sectors	15,785,000	17,749,000
Manufacturing	3,920,000	5,785,000
Finance and insurance	2,782,000	3,816,000
Information	2,086,000	2,124,000
Management of companies	1,845,000	1,908,000
Retail trade	1,077,000	1,139,000
Wholesale trade	882,000	915,000
Professional, scientific, and technical services	565,000	1,042,000
All other industries	1,791,000	1,854,000

Source: GAO analysis of IRS Statistics of Income. | GAO-22-105264

Notes: Lower and upper bound estimates are the 95 percent confidence interval. Data are from IRS Form 3800.

All other industries includes: accommodation and food services; utilities; construction; mining; other services; transportation and warehousing;

<sup>31</sup>IRS did not publicly report the estimated counts of corporate returns claiming the credit by industry. Industry sectors are classified according to the North American Industry Classification System (NAICS). NAICS is the standard used by federal statistical agencies in classifying business establishments for the purpose of collecting, analyzing, and publishing statistical data related to the U.S. business economy. On the Form 1120, *U.S. Corporation Income Tax Return*, taxpayers are instructed to determine from a provided list which business activity the company derives the largest percentage of its total receipts, to self-report their principal business activity. The list of principal business activity that the IRS uses is based on the NAICS. According to IRS officials, self-reported Principal Business Activity Codes are reviewed during SOI processing.

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health care and social assistance; arts, entertainment, and recreation; educational services; administrative and support and waste management and remediation services; agriculture, forestry, fishing, and hunting; and real estate and rental and leasing.

Although corporate returns account for most of the aggregate credit claim amounts, some individual filers also benefit from the credit as partners and shareholders of employers claiming the credit. In 2018, the most recent year available at the time of our analysis, an estimated 16,846 to 21,378 individual income tax returns claimed a total estimated \$6,382,000 to \$7,953,000 in employer-provided child care credits on Form 3800 (see table 6). For perspective on this population size, an estimated 633,181 to 695,007 individual tax returns filed Form 3800 in 2018. Individual income tax returns claiming the credit include partners or shareholders claiming their portions of a partnership or S corporation's credit. As such, each individual income tax return does not necessarily represent an individual employer or an individual child care facility.

**Table 6: Estimated Range of the Number of Individual Returns Claiming the Employer-Provided Child Care Credit and Total Amount Claimed, 2013-2018**

Year	Counts		Amounts(in dollars)	
	Lower bound	Upper bound	Lower bound	Upper bound
2013	13,705	17,539	8,424,000	14,247,000
2014	14,356	7,943	9,125,000	14,465,000
2015	13,601	17,459	4,672,000	6,291,000
2016	12,971	16,506	4,930,000	6,415,000
2017	16,420	20,853	5,876,000	7,711,000
2018	16,846	21,378	6,382,000	7,953,000

Source: GAO analysis of IRS Statistics of Income. | GAO-22-105264

Note: Lower and upper bound estimates are the 95 percent confidence interval. Data are from IRS Form 3800.

While Form 3800 reflects the numbers and amounts of child care credits claimed, Form 8882 provides information on qualified child care facility and resource and referral expenses reported by some corporate employers.<sup>32</sup> In 2018, the most recent year available, IRS estimated 143 to 166 corporate income tax returns reported an estimated total of \$144,742,000 to \$154,812,000 in qualified child care facility expenditures on Form 8882.<sup>33</sup> Corporate income tax returns reported fewer qualified resource and referral expenditures than facility expenditures in 2018.<sup>34</sup> IRS estimated 28 corporate income tax returns reported an estimated \$6,603,000 in qualified child care resource and referral expenditures.<sup>35</sup> Appendix I provides estimated ranges of qualified child care expenditures and credit amounts from corporate returns filing Form 8882.

<sup>32</sup>Not all corporate taxpayers are required to file a Form 8882. IRS does not publicly report statistical data on partnership or individual income tax returns filing Form 8882.

<sup>33</sup>Qualified child care facility expenditures are eligible for the 25-percent credit rate, subject to the allowable credit limit.

<sup>34</sup>Resource and referral expenditures are eligible for the 10-percent credit rate, subject to the allowable credit limit.

<sup>35</sup>IRS provided the confidence intervals which we present without rounding. IRS Statistics of Income are based on a stratified random sample of tax returns. Corporate return data are stratified by size of total assets and size of “proceeds,” the measure of income for Form 1120. The stratified design ensures a higher percentage of returns in the sample are from larger firms, to obtain a more reliable measure of totals. A high percentage of returns from larger firms, selected in the certainty strata, may result in confidence intervals with the same lower and upper bound.

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## Several Factors May Limit Employers' Use of the Credit, but Groups We Interviewed Identified Various Options to Increase Use

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Reported Factors That May Limit Employers' Use of the Credit Include Cost and Complexity of Providing Child Care, Awareness of the Credit, and Design of the Credit

### Cost and Complexity of Providing Child Care

Use of the credit may be limited because substantial initial and long-term costs involved in providing a child care facility often deter employers from providing child care, according to selected groups examining employers, workers and families, and child care issues that we interviewed. For example, representatives from several groups said that providing an on-site child care center requires significant capital investment due to the costs of building or acquiring a facility.<sup>36</sup> They also told us that the operational costs of a center require long-term financial commitment.

Small employers in particular face steep challenges, according to the groups we interviewed.<sup>37</sup> Specifically, one group that provides child care services for employers told us that employers need to have a suitable space for an on-site or near-site child care center, the capital to build or retrofit the space, and enough employees to use the center—factors that leave out many small employers. Another group focused on policy echoed that small businesses often lack the scale and capacity to provide child care for employees.

The complexity of planning and administering on-site child care services may also discourage employers from considering it for their employees. For example, planning an on-site child care center may involve assessing applicable laws and regulations of the state and local government,

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<sup>36</sup>IRS officials noted that the term “on-site” is not defined or used in IRC section 45F.

<sup>37</sup>The Small Business Administration generally defines the size of a small business in terms of its level of revenue or the number of employees ranging from 100 to 1,500 employees, depending on its industry classification. However, the groups we interviewed that referred to small employers generally did not provide a definition of the term.

including licensing of the facility for child care provision, which are areas that employers may have little knowledge about.

Other considerations may include assessing the legal liability of operating an on-site child care center or employees' child care needs and selecting the types of services that fit them. Often these needs can vary among employees. For example, one public policy research group said that some employees may need care options closer to their homes over employer-provided on-site child care.

Given all of this, employers may prefer simpler, less costly alternatives to support child care for employees. For example, one group focused on family and women's issues said DCAPs are easier to set up and less expensive to administer than child care services that qualify for the Employer-Provided Child Care Credit.

### Employers' Awareness or Understanding of the Credit

Employers are often not aware of the credit, according to the business, child care, and policy groups we interviewed. For example, a representative at one group that provides child care services to many large employers told us that almost none of their clients were aware of the credit. In particular, the representative said that large employers may not be aware of the credit in part because the \$150,000 annual limit of the credit may be too small compared to their other financial management considerations.

Employers also lack a clear understanding of how the credit can be applied, including which types of child care services or child care arrangements are eligible under the credit. For example, representatives from two groups said that employers often believe the credit is limited to expenses related to an on-site child care facility and do not realize expenses related to contracting with a child care facility or resource and referral services are eligible. In particular, smaller employers are more likely to lack awareness or an understanding of the credit, according to groups we interviewed. For example, small employers may not have time or administrative resources—such as access to human resource specialists and tax advisors—to learn about the credit.

### Credit Design

Groups we interviewed told us that the size of the credit may be too small to affect employers' decisions to offer child care. For example, a

representative from a group that provides child care services told us that building an on-site child care center can cost from \$1 to \$3 million and the credit's annual limit (\$150,000) is too low to sufficiently incentivize larger employers. Many small employers are not likely to see the credit as providing enough financial assistance, according to another group representing employers.

Representatives from some of the groups we interviewed told us that many employers do not have sufficient federal tax liability to use the credit. The Employer-Provided Child Care Credit is a nonrefundable tax credit, meaning that it can reduce a taxpayer's federal income tax liability to zero but cannot result in a tax refund for the taxable year.<sup>38</sup> In a policy memo on the credit, one group focused on family and women's issues cited federal research indicating a majority of active corporations had no federal tax liability and added that certain employers that are generally exempt from federal taxes, such as nonprofit organizations, are not eligible to claim the credit.<sup>39</sup>

Further, the types of child care services that qualify for the credit may not meet the diverse child care needs of employees. For example, representatives from several groups said that some employees may prefer child care services provided in their own home rather than bringing their children to an employer's on-site child care center. However, because the credit defines an eligible child care facility as one that must provide child care as its principal use and meet the requirements of all applicable state and local laws and regulations, expenses for in-home child care services are generally not eligible for credit.

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<sup>38</sup>The credit is a component of the general business credit and is subject to its limitation and carryover provisions. 26 U.S.C. § 38(b)(15). The general business credit is generally nonrefundable, but if a taxpayer does not have sufficient tax liability against which to use the credit in a current tax year, the taxpayer may either carry back some or all of the credit to the preceding tax year (if it had tax liability that year), or carry the credit forward for use in a future tax year up to 20 years. 26 U.S.C. § 39.

<sup>39</sup>We previously reported that in each year from 2006 to 2012, at least two-thirds of all active corporations had no federal income tax liability. Larger corporations were more likely to owe tax. Among large corporations (generally those with at least \$10 million in assets) less than half—42.3 percent—paid no federal income tax in 2012. Of those large corporations whose financial statements reported a profit, 19.5 percent paid no federal income tax that year. GAO, *Corporate Income Tax: Most Large Profitable U.S. Corporations Paid Tax but Effective Tax Rates Differed Significantly from the Statutory Rate*, [GAO-16-363](#) (Washington, D.C.: Mar. 17, 2016).

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## Groups We Interviewed Suggested Increasing Outreach and Education about the Credit and Identified Various Options to Redesign the Credit

The groups we interviewed described a number of options to address challenges that may limit employers' use of the tax credit. To enhance employers' awareness and understanding of the credit, groups we interviewed suggested the following:

- Agencies, such as IRS, could create and disseminate information on how the tax credit works and how it can be used by employers in various situations.
- Child care resource and referral networks could increase information sharing about the credit with their membership.
- National business associations could serve as conduits for reaching employers by inviting an IRS expert to join a call with their members or submit a newsletter article explaining the credit.
- State or local chambers of commerce or business coalitions could educate employers about the credit.

To address design factors that may limit use, groups we interviewed identified the following options:

- raising the portion of an employer's child care expenditures that can be offset by the credit as well as the maximum allowable credit;
- expanding the definition of services eligible for the credit to include in-home child care;
- extending the credit to employers that do not have federal tax liability, including nonprofit organizations, which are exempt from federal income taxes<sup>40</sup>; or
- allowing multiple employers that jointly acquire, construct, or operate a qualified child care facility to claim the credit, which could help small employers.<sup>41</sup>

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<sup>40</sup>Treasury officials stated that, to extend the credit to employers that do not have federal tax liability, it could be made refundable or allowed to be applied against FICA taxes. Either option would allow more employers to benefit from the credit. However, they noted that these options would require significantly increased oversight by the IRS.

<sup>41</sup>IRS officials stated that this type of arrangement is not addressed in the statute.

However, some of the groups we interviewed told us they did not believe that changes to the credit would increase employers' use of the credit. For example, one group that focuses on worker and family issues explained that the declining number of states offering employer-provided child care tax credits over the past three decades is evidence that incentivizing employers to invest in child care through such credits is an ineffective policy strategy. Regarding on-site employer-provided child care specifically, two public policy groups raised the possibility that if remote work becomes more common, employee interest in on-site child care may decrease, further disincentivizing employers to offer it. In addition, redesigning the credit to incentivize more employers to use it may result in increased costs to the federal government, although we did not project the potential forgone revenue or cost for IRS oversight.

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## Groups We Interviewed Described How Employer-Provided Child Care May Help Employees but Raised Issues about Access and Affordability

According to our literature review and interviews conducted with selected groups, employees using employer-provided child care, especially when it is on-site, are more productive, focused, and engaged, and may have greater peace of mind and reduced stress with their children in close proximity during the work day. Both employers and employees may benefit from employer-provided child care through reduced employee absenteeism and turnover.

Several groups we interviewed also said that when an employer provides child care, it can strengthen the employer-employee relationship, build trust, and make employees feel valued. One business group representative said that their own research found that when employers provide on-site child care, all employees (not just those with children) tend to view the employer more favorably because it helps minimize work disruptions when parents who cannot obtain child care on their own must stay at home.

Even when an employer provides child care, it may not be available, accessible, or affordable for all employees. For example, several of the groups we interviewed described employers who offer on-site child care at a corporate headquarters, but not to employees located in warehouses,



distribution centers, or retail outlets. Child care may not be conveniently located depending on the employee's distance from the facility or commute. Accessing child care can be particularly challenging for those who work shifts or non-traditional hours. Two groups also mentioned that employer-provided child care often has limited capacity and waitlists.

A representative with a public policy research group said that, even with employer subsidies, typically only high-income employees can afford employer-provided child care. While a sliding scale may address the issue of equity to some degree, child care, like health care, can be a significant cost for employees, according to a group that provides child care services for employees.

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## Agency Comments

We provided a draft of this report to IRS and Treasury for comment. They provided technical comments, which we incorporated as appropriate.

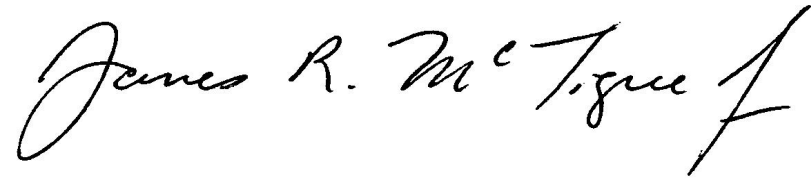
We are sending copies of this report to the appropriate congressional committees, the Secretary of the Treasury, and the Commissioner of IRS. In addition, the report is available at no charge on our website at <http://www.gao.gov>.

If you or your staff have any questions concerning this report, please contact Kathryn A. Larin at (202) 512-7215 or [larink@gao.gov](mailto:larink@gao.gov), or James R. McTigue, Jr. at (202) 512-6806 or [mctigueJ@gao.gov](mailto:mctigueJ@gao.gov). Contact points for our Offices of Congressional Relations and Public Affairs may be found on the last page of this report. Key contributors to this report are listed in the appendix II.



Kathryn A. Larin  
Director, Education, Workforce, and Income Security

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A handwritten signature in black ink that reads "James R. McTigue, Jr." The signature is written in a cursive style with a large, stylized initial 'J' and a long, sweeping tail on the 'e'.

James R. McTigue, Jr.  
Director, Tax Issues  
Strategic Issues

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# Appendix I: Estimated Range of the Number of Corporate Returns Reporting Qualified Child Care Expenditures and Claiming the Credit on Form 8882

**Table 7: Estimated Range of the Number of Corporate Returns Reporting Qualified Child Care Facility Expenses and Total Amount Reported, 2013-2018**

Year	Counts		Amounts (in dollars)	
	Lower bound	Upper bound	Lower bound	Upper bound
2013	141	215	155,844,000	166,579,000
2014	144	217	125,770,000	134,197,000
2015	Unavailable	Unavailable	Unavailable	Unavailable
2016	136	245	135,369,000	149,250,000
2017	149	196	141,736,000	154,852,000
2018	143	166	144,742,000	154,812,000

Legend: Unavailable = This value (and the associated dollar amount) was suppressed by the Internal Revenue Service to avoid disclosure of information for specific corporations.

Source: GAO analysis of IRS Statistics of Income. | GAO-22-105264

Notes: Lower and upper bound estimates are the 95 percent confidence interval. Data are from Line 1 of IRS Form 8882.

**Table 8: Estimated Range of the Number of Corporate Returns Reporting Child Care Resource and Referral Expenses and Total Amount Reported, 2013-2018**

Year	Counts		Amounts (in dollars)	
	Lower bound	Upper bound	Lower bound	Upper bound
2013	32	46	6,546,000	7,507,000
2014	31	39	5,141,000	5,878,000
2015	28	28	5,167,000	5,178,000
2016	32	32	5,731,000	5,966,000
2017	31	31	6,533,000	6,569,000
2018	28	28	6,603,000	6,603,000

Source: GAO analysis of IRS Statistics of Income. | GAO-22-105264

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**Appendix I: Estimated Range of the Number of  
Corporate Returns Reporting Qualified Child  
Care Expenditures and Claiming the Credit on  
Form 8882**

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Notes: Lower and upper bound estimates are the 95 percent confidence interval. Data are from Line 3 of IRS Form 8882.

**Appendix I: Estimated Range of the Number of Corporate Returns Reporting Qualified Child Care Expenditures and Claiming the Credit on Form 8882**

**Table 9: Estimated Range of the Number of Corporate Returns Claiming the Employer-Provided Child Care Credit and Total Amount Claimed, 2013-2018**

Year	Counts		Amounts (in dollars)	
	Lower bound	Upper bound	Lower bound	Upper bound
2013	168	242	15,085,000	17,049,000
2014	169	242	14,795,000	16,869,000
2015	161	247	15,321,000	17,453,000
2016	166	274	15,320,000	18,420,000
2017	171	218	15,525,000	18,612,000
2018	164	187	15,206,000	17,699,000

Source: GAO analysis of IRS Statistics of Income. | GAO-22-105264

Notes: Lower and upper bound estimates are the 95 percent confidence interval. Data are from Line 7 of IRS Form 8882. For any given taxpayer, the credit amount calculated on the Form 8882 may not be the same as the credit amount claimed on Form 3800. Not all taxpayers are required to file a Form 8882. Only credit amounts claimed by partnerships, S corporations, estates, and trusts must be reported on Form 8882. Some corporate and individual taxpayers claim their portion of credits passed through from partnerships, for example, directly on the Form 3800.

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## Appendix II: GAO Contacts and Staff Acknowledgments

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Kathryn A. Larin, (202) 512-7215 or [larink@gao.gov](mailto:larink@gao.gov)

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### Staff Acknowledgments

In addition to the contacts named above, Danielle Giese and MaryLynn Sergent (Assistant Directors), Edward Bodine and Mackenzie D. Verniero (Analysts-in-Charge), Julie Anderson and Tania Uruchima made key contributions to this report. Also contributing to the report were Andrew Bellis, James Bennett, Jacqueline Chapin, William Chatlos, Nina Crocker, Steven Flint, Avani Locke, Carl Nadler, Ed Nannenhorn, Jessica Orr, Sam Portnow, Andrew J. Stephens, Sonya Vartivarian, and Alicia White.

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