The new-and-improved credit for employer-provided child care

Offering a broad menu of employee benefits can help your business attract and retain skilled workers. One benefit that's popular among employees with families is employer-provided child care. Although this option hasn't been financially feasible for many small businesses, recent tax law changes may give you a reason to reconsider opening (or upgrading) a child care facility, contracting with a child care provider or participating in a jointly operated arrangement. Here's an overview of the credit and how it's been enhanced starting in 2026.

Recent changes

Under Section 45F of the tax code, employers may claim a tax credit for eligible expenses paid or incurred to provide child care to employees. For 2026, the credit has increased from 25% to 40% of an employer's qualified child care facility expenditures, plus 10% of its qualified child care resource and referral expenditures paid or incurred during the tax year. It's limited to a total of $500,000 per tax year (up from $150,000 for 2025). Beginning in 2027, the $500,000 limit will be adjusted annually for inflation.

The credit has been further enhanced for certain small businesses. If you meet the eligibility requirements, you can claim a credit equal to 50% of qualified child care facility expenses, plus 10% of qualified resource and referral expenditures, up to a maximum of $600,000 for 2026 (annually inflation-adjusted going forward).

Eligible small businesses are generally those that had average annual gross receipts for the previous five tax years below an inflation-adjusted threshold. For 2026, the threshold is $32 million.

Also, eligible small businesses can now pool their resources to provide child care for their employees and to use third-party intermediaries to facilitate child care services. These options may make the credit more accessible to businesses that can't justify operating their own facilities.

Qualified expenditures

Qualified child care facility expenditures are amounts paid or incurred to:

- Acquire, construct, rehabilitate or expand property that's 1) to be used as part of your qualified child care facility, 2) depreciable or amortizable, and 3) not part of your principal residence or an employee's home,
- Operate your qualified child care facility, including the costs to train and compensate its employees and provide scholarship programs, or
- Contract with a qualified child care facility to provide eligible services to your employees.

It's important to note that qualified child care expenses *exclude* amounts that exceed the fair market value of providing such care.

A qualified child care facility is one that meets all state and local regulatory requirements. In addition, the facility 1) must be used principally to provide child care (unless it's also the personal residence of the person who operates it), 2) must be open to all employees during the tax year, and 3) can't discriminate in favor of highly compensated employees. And, if the facility is your principal trade or business, at least 30% of enrollees must be your employees' dependents.

Additional rules

To avoid doubling your tax benefits from the same expenditures, your tax basis in any qualified child care facility is reduced by the amount of the credit attributable to facility-related expenditures. You also can't claim other deductions or credits based on the same expenses.

In addition, if your child care facility ceases to operate as such or undergoes a change in ownership before the tenth tax year after the tax year in which it's placed in service, you may have to recapture (pay back) some or all of the credit. The percentage of the credit that must be recaptured decreases gradually over the 10-year period.

The Sec. 45F credit is part of the general business credit, which is composed of more than 30 separate tax credits that are subject to combined limits based on your tax liability. So the amount you can use in the current year may be limited. However, any unused credit can generally be carried back one year and carried forward for 20 years. The credit is calculated and claimed on Form 8882, “Credit for Employer-Provided Childcare Facilities and Services.”

Look before you leap

Providing child care for your employees can be a major long-term investment. Although the recent enhancements to the employer-provided child care credit help make this benefit option more feasible, it isn’t right for every employer. You should also consider workforce demographics, operational costs, available providers, and the associated risks and responsibilities. Even when outsourcing, you’ll have to exercise due diligence to select a reputable provider, monitor service quality and make changes as necessary.

If you’re interested in pursuing this family-friendly benefit, we can help you evaluate the pros and cons and model the credit’s potential value. Contact us for more information and assistance.