Tennesseans for Quality Early Education

Child Care in the 2025 Federal Tax Reconciliation Package

The final version of the 2025 tax reconciliation package (the One Big Beautiful Bill Act – H.R.1) was signed into law on July 4th, 2025. The bill permanently improves three pieces of tax policy that help make child care more affordable for working families with young children.

TQEE's child care study: *Workforce of Today and Tomorrow: The Economics of Tennessee's Child Care Crisis*, revealed more than 80 percent of Tennessee's working parents experience employment disruptions due to inadequate child care. They cite affordability, quality and access as major challenges.

At the same time, Tennessee employers recognize child care is essential economic infrastructure — impacting their ability to recruit and retain employees — and they're seeking cost-effective solutions.

Government tax policy can help make child care more affordable for working families; and the federal tax reconciliation package includes **3 important changes**:

- Grows Dependent Care Assistance Plans (DCAP) - last updated in 1986
- Expands the Child and Dependent Care Tax Credit (CDCTC) - last updated in 2001
- Improves the Employer-Provided Child Care Credit (45F) -last updated in 2001

Grows Dependent Care Assistance Plans (DCAP)

DCAPs allow working parents to set aside pre-tax income to pay for child care in an employer-offered flexible spending account (similar to health spending accounts).

What Changed?

For families whose employer participates in DCAP – there's an increase from $5500 to $7500 in the amount they can deduct annually from their pre-tax earnings to pay for dependent care expenses.

Details	Previously	The New Law
Amount a household can put into a pre-tax flexible spending account to use on child care	$5,000	$7,500

Expands the Child and Dependent Care Tax Credit (CDCTC)

The CDCTC is the only tax credit that directly helps low- and middle-income working parents keep more of what they earn to pay for child care.

What changed?

- Parents can still claim up to $3,000 (for one child) or $6,000 (for two or more children) in child care expenses on their annual federal income taxes.
- But, whereas previously the tax credit covered up to 35% of those expenses depending on income, now families with the lowest incomes will receive up to 50% back as a credit.

Details	**Previously**		**The New Law**		**The Difference**
Your family's income (married filing jointly):	Percentage of your claimed expense:	Max credit for two children:	Percentage of your claimed expense:	Max credit for two children:	This is a potential increase of …
$30-$34K	34%	$2,040	49%	$2,940	$900
$58-$62K	27%	$1,620	42%	$2,520	$900
$86-$150K	20%	$1,200	35%	$2,100	$900
$182-$186K	20%	$1,200	26%	$1,560	$360
$206K +	20%	$1,200	20%	$1,200	SAME

Improves the Employer-Provided Child Care Credit (45F)

45F supports businesses who want to help locate or provide child care for their employees.

What changed?

- For employers investing in child care services for their employees, the maximum tax credit increased from $150,000 (based on 25% of their qualified child care expenses) to:
  - $500,000 (based on 40% of expenses) for larger businesses
  - $600,000 (based on 50% of expenses) for smaller businesses
- PLUS: Now small businesses can pool resources to contract with a qualified child care provider and qualify jointly for the tax credit.

Details	**Previously**	**The New Law**
% of child care expenses covered	25%	40% for larger businesses, 50% for small businesses
Maximum Credit	$150,000	$500,000 for larger businesses $600,000 for small businesses
Allows small businesses to pool resources to contract with a qualified child care provider	No	Yes

Thanks to The First Five Years Fund who provided the charts and kept us informed on the changes.