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State Child Care Tax Benefits

Background

The landscape of child care in the United States is one marked by a delicate balance between the needs of working families, the challenges faced by child care operations, and the complicated web of federal and state policies designed to support both. According to a recent U.S. Department of Labor report, the price of child care for one child ranges between 8% to 19% of the median family income nationally. Families with multiple young children are likely to spend more on child care than housing, traditionally the largest expenditure for families.

The cost of child care is influenced by various factors, such as the child's age and the size of the resident's county. Notably, infant care in highly populous counties stands out as the most expensive form of care. Compounding this financial strain is the labor-intensive nature of the child care sector, where more than 60% of operating costs are allocated to compensation for child care professionals. Regulatory measures, such as maximum child to provider ratios aimed to bolster child safety and increase care quality, increase labor demand as the number of children under care increases. Consequently, these factors combine to reduce profit margins for operators. As American Rescue Plan funding concludes this year, concerns rise over the potential closure of tens of thousands of child care centers, highlighting the sector's financial fragility.

Historically, federal and state governments have employed a mix of direct and indirect subsidies, including expenditures and tax incentives, to offset child care costs. This memo provides an overview of state approaches to tax benefits, supporting both families and employers in affording child care. Additionally, it explores innovative state tax incentives aimed at recruiting and retaining effective child care professionals and early childhood educators.

State Approaches to Child Care Tax Benefits

Supporting Families

State Child and Dependent Care Credits

The Child and Dependent Care Tax Credit (CDCTC) is a federal tax benefit that assists families in paying for expenses like child care and care for an adult dependent(s) unable to take care of themselves. This credit specifically offsets the cost of child care (or other dependent care) based on the amount of eligible expenses the taxpayer incurs. Compared with the other tax incentives discussed in this memo, CDCTCs are a direct subsidy for child care as it requires families to expend their resources on child care services before they receive a credit.

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As of 2024, **27 states and the District of Columbia** provide some form of their own Child and Dependent Care Tax Credit (CDCTC): Arkansas, California, Colorado, Delaware, Washington D.C., Hawaii, Georgia, Iowa, Kansas, Kentucky, Louisiana, Maine, Maryland, Massachusetts, Minnesota, Nebraska, New Jersy, New Mexico, New York, Ohio, Oklahoma, Oregon, Rhode Island, South Carolina, Vermont, and Wisconsin. In addition, instead of a credit, Idaho and Virginia offer a deduction for child and dependent care expenses. See the attached excel spreadsheet for more information from Bloomberg Tax Research providing details and citations for each state CDCTC.

States may harmonize their own CDCTC with the federal policy by offering it to dependents both young and old and granting recipients a certain percentage of their federal credit. However, some states have targeted programs to offer tax relief for expenses incurred for either child care or elder care, not both. Eligibility requirements for these policies differ by state, but common components include gainful employment and claiming the federal CDCTC.

State Child Tax Credits

Like the CDCTC, the Child Tax Credit (CTC) was originally established by the federal government. This tax benefit provides general financial relief to lower-income families based on income and number of children. As things stand currently, **15 states** have CTCs of their own: Arizona, California, Colorado, Idaho, Maine, Maryland, Massachusetts, Minnesota, New Jersey, New Mexico, New York, Oklahoma, Oregon, Utah, and Vermont.

State CTCs operate in addition to the Federal CTC. Eligibility requirements vary by state significantly, and credit amounts depend on income level, marital status, and number of dependent children. In addition, 11 of the 15 states have made these credits refundable. State policymakers increasingly view CTCs as another tool to offset the costs associated with raising children, including day care expenses. In contrast with CDCTCs, CTCs are a more indirect subsidy of child care since families can use credits for any type of expense instead of just for child care services. NCSL has a thorough resource detailing each state's policy, and you can find the latest version of this resource here.

State Earned Income Tax Credits

Earned income tax credits (EITCs) are a common policy approach used by the federal and many state governments to bolster economic security of low-income working households. These tax credits reduce family's income tax liabilities and allow them to retain more of their income. Although state EITCs are an indirect subsidy for child care expenses, state policymakers often point to them as additional resource to help working families afford child care expenses, in addition to other goods and services.

State EITCs provide additional benefits to the federal credit for low-income taxpayers by reducing their state tax liability. While most are modeled after the federal EITC, state policies can vary based on eligibility requirements, how much credit taxpayers may receive, and whether the credit is refundable. In total, **31 states, the District of Columbia, Guam, and Puerto Rico** have their own EITCs. NCSL has an extensive resource covering this topic with detailed information about each state's policy, which you can find here.

Supporting Employers

Employer Child Care Tax Credits

In addition to supporting families, many states employ tax benefits that are designed to help employers provide affordable child care options for their employees. States commonly provide tax credits to employers that operate or contract out child care services for their employees. These tax credits allow businesses to claim expenses related to child care operations and reduce their corporate income tax liability in turn. The goal of these policies is to help with the initial costs of creating facilities, often with construction and labor required to build employer-operated child care facilities. Other states also provide operation support to offset the costs of contracting child care services on behalf of employees.

According to the Committee for Economic Development—a non-partisan, business-led public policy organization—at least **17 states** offer employer sponsored child care tax credits: Arkansas, Colorado, Connecticut, Georgia, Illinois, Iowa, Kansas, Maryland, Mississippi, Montana, New Mexico, New York, Oregon, Rhode Island, South Carolina, Virginia, and West Virginia. See the attached spreadsheet with data gathered from the CED for specific details on each state's policy. This information also includes other, less common business tax incentives like employer-state match programs, child care contribution/donation tax credits, and child care property tax exemptions.

Growing the Child Care Workforce

The child care workforce has long been characterized by lower hourly wages and declining interest in the profession. One report used data from the Bureau of Labor Statistics to show the median hourly wage for child care professionals was $13.71 in 2022, with projected negative growth in labor supply for the sector. Overall, child care workers are more than twice as likely to live below the poverty line compared to workers in other sectors.

In an effort to recruit new people to enter the child care workforce, as well as retaining those already in the profession, some states have begun to offer targeted tax benefits. These policies replicate the approaches states have enacted via legislation to recruit and retain K-12 educators: using income tax credits which increase in value based on years of service and higher credential attainment. Below are a few state examples of this approach applied to child care workers.

STATE EXAMPLES

- **Colorado:** Early Educator Tax Credit
  - Between tax year 2020-2026, eligible early childhood educators are allowed to claim income tax credits if they work at least 6 months in a licensed family child care provider or child care center. The amount of credit is based on the taxpayer's credential.
  - Colo. Rev. Stat. § 39-22-547
- **Louisiana:** Credit for child care directors and staff
  - Like Colorado, Louisiana provides a refundable income tax credit based on child care staff's credentials and level of education if they have worked in a center for at least six months. In addition, the state annually adjusts the credit amounts based on the increase in the Consumer Price Index United States city average.
  - La. Stat. Ann. § 47:6106
- **Nebraska:** School Readiness Tax Credit Act

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- Much like the previous two states, Nebraska offers an income tax credit for child care staff based on their classification (credential). In addition, the state will begin to index credit amounts to CPI-U like Louisiana starting in 2025.
- Neb. Rev. Stat. Ann. § 77-3605

Additional Resources

- U.S. Department of Labor, Women's Bureau (2023): *Childcare prices in Local Areas*
- Bipartisan Policy Center (2023): *State Child Care Tax Supports for Businesses and Parents*
- NCSL (2023): *Earned Income Tax Credit Overview*
- NCSL (2023): *Child Tax Credit Overview*
- Committee for Economic Development (2022): *State Tax Credits for Child Care*
- National Women's Law Center (2023): *States Can Make Care Less Taxing: Tax Credits Related to Child Care, Tax Year 2022*

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