

**Child Care Plans:  
Big Breaks,  
Small Cost**





# **Child Care Plans: Big Breaks, Small Cost**

**SPIDELL PUBLISHING, INC.**

**P.O. Box 61044  
Anaheim, CA 92803-6144**

**1158 N. Gilbert Street  
Anaheim, CA 92801-1401**

**Phone: (714) 776-7850  
Fax: (714) 776-9906**

**Web site: [www.caltax.com](http://www.caltax.com)  
E-mail: [subscription@spidell.com](mailto:subscription@spidell.com)**

© 2004  
Fifth Edition  
May 2004

This publication is distributed with the understanding that the authors and publisher are not engaged in rendering legal, accounting, or other professional advice and assume no liability in connection with its use. Tax laws are constantly changing and are subject to differing interpretations. In addition, the facts and circumstances in your particular situation may not be the same as those presented here. Therefore, we urge you to do additional research and ensure that you are fully informed before using the information contained in this publication. Federal law prohibits unauthorized reproduction of the material in **Child Care Plans: Big Breaks, Small Cost** booklet. All reproduction must be approved in writing by Spidell Publishing, Inc.

## Table of Contents

How You Can Get Big Tax Breaks with California’s Employer Child Care Credits.....	1
How to Fund a Child Care Plan .....	2
California Employer Child Care Contribution Credit.....	2
California Employer Child Care Program Credit .....	5
Federal Credit for Employer-Provided Child Care Facilities .....	7
Using State and Federal Credits Together .....	7
Relationship with Child and Dependent Care Expenses Credit.....	10
Rules for Both California Employer Credits .....	11
Why Establish a Plan? .....	13
Sample Letter Explaining Employer Child Care Credits.....	21
Flow Chart to Determine California Employer Child Care Contribution Credit.....	23
Flow Chart to Determine California Employer Child Care Program Credit .....	25
Appendix 1 – Form FTB 3501, <b>Employer Child Care Program/Contribution Credit</b> , and instructions .....	Appendix 1
Appendix 2 – Federal Form 8882, <b>Credit for Employer-Provided Childcare Facilities and Services</b> , and instructions .....	Appendix 2
Appendix 3 – Federal Form 2441, <b>Child and Dependent Care Expenses</b> , and instructions .....	Appendix 3



## **How You Can Get Big Tax Breaks with California's Employer Child Care Credits**

One of California's most liberal tax benefits is also apparently one of the least understood and least used. Since 1988 California has provided employers with these very lucrative tax credits:

- Employer Child Care Contribution Credit — Making contributions to a qualified child care plan for any California employee's dependent(s) under the age of 12 (this includes a self-employed individual's own dependent(s)); and
- Employer Child Care Program Credit — Paying or incurring costs for the startup expenses of establishing a child care program or constructing a child care facility in California, to be used primarily by the employees' children or by the children of the tenants' employees, or both.

And, for taxable years beginning on or after January 1, 2002, federal law also provides a credit to employers who provide child care or construct facilities for employees' child care (IRC §45F).

So you and your clients can take advantage of these generous tax credits, we have prepared this special report. The California Employer Child Care Contribution Credit and the Employer Child Care Program Credit are scheduled to expire for taxable years beginning on or after January 1, 2007, while the federal credits sunset December 31, 2010. This special report includes:

- a flow chart to determine eligibility for the California Employer Child Care Contribution Credit;
- a flow chart to determine eligibility for the California Employer Child Care Program Credit;
- a list of some of the tax and other benefits that come from a child care plan and program;
- a comparison of the federal and California credits;
- examples showing the tax benefits generated by an employer-sponsored child care plan and program, how the tax benefits reduce an employer's out-of-pocket costs, and how to maximize the employer's benefits;
- a sample letter to send your clients that explains the benefits of a child care contribution plan; and
- a sample child care contribution plan.



### **Tax Tip**

If you or any of your clients was eligible and had met the requirements for one of these credits in a prior year but did not claim them, you may file amended returns if the statute of limitations is still open.

## **How to Fund a Child Care Plan**

The best way to fund a child care plan is by taking advantage of the tax benefits that are allowed under both federal and state tax laws.

Here is what you and your clients may qualify for with a child care plan:

- A California Employer Child Care Contribution Credit of up to \$360 per employee's dependent who is under the age of 12, if certain requirements are met and a credit of 30 percent of the cost of constructing a qualified child care facility or setting up a child care referral service with a maximum credit of \$50,000 in any given taxable year.
- A California deduction for the expenses in excess of the Employer Child Care Contribution Credit (except for a self-employed individual's own child care expenses), if otherwise qualified.
- For taxable years beginning on or after January 1, 2002, a 25 percent federal credit (a maximum credit of \$150,000) for employer-provided child care facilities and services, including those expenses incurred under a contract with a qualified child care facility to provide child care services to the taxpayer's employees, and 10 percent credit for qualified child care resource and referral expenses. These credits are limited to \$150,000 in any given taxable year (IRC §45F).
- A federal deduction for the amount of expenses in excess of any federal credit taken, if otherwise qualified (except for a self-employed individual's own child care expenses).

First we'll look at how the California credit works, second we'll look at the federal credit, and finally we'll show how one taxpayer, with proper planning, may benefit from both credits.

### **California Employer Child Care Contribution Credit**

With California's Employer Child Care Contribution Credit, employers may take a credit of 30 percent of the qualified child care expenses paid or incurred on behalf of a qualified employee's dependent. The maximum credit is \$360 per employee's dependent. To take the maximum credit, the child care must be provided at least 42 weeks in any taxable year (R&TC §§17052.18 and 23617.5).

If the plan is also qualified under IRC §125, the employer may deduct the expenses as an employee benefit expense from the federal and California returns. For California purposes, however, you must reduce the business expense deduction by the amount of the credit.

#### **Qualified care plan**

To qualify for the credit, an employer must establish a "qualified care plan." Qualified care includes care provided at:

- an onsite service, meaning at the employer's place of business;
- a child care center;
- the private home of a child care provider;



## *Child Care Plans: Big Breaks, Small Cost*

- the employee’s home; or
- a dependent care center that is a specialized center with respect to short-term illnesses of an employee’s dependents. See IRC §21(b)(2)(D) and R&TC §§17052.18 and 23617.5 for more information on specialized centers.

Qualified care must be provided in California under the authority of a license, when required by California law.

No credit is allowed if the care is provided by:

- a dependent of the employee or that employee’s spouse under R&TC §17054(d)(1); or
- the employee’s son, stepson, daughter, or stepdaughter (within the meaning of R&TC §17056) who is under the age of 19 at the close of that taxable year.

### **Qualified dependent**

A qualified dependent means any qualified employee’s dependent who is under the age of 12.

#### **Example of Employer Child Care Contribution Credit**

Slavedriver, Inc., has one employee, Bea Worker. Bea has two children, Ben, who is eight, and Brad, who is two. Slavedriver has an IRC §129 plan that pays up to \$2,400 per year per child in child care expenses on behalf of qualified employees.

Ben’s child care expenses are \$90 per month and Brad’s expenses are \$200 per month, which Slavedriver pays directly to the child care providers. Slavedriver is entitled to take the following credit on the California return:

<u>Child’s Name</u>	<u>Expenses Paid</u>		<u>Application Percentages</u>	<u>Tentative Credit</u>	<u>Allowable Credit (lesser of Tentative Credit or \$360)</u>
Ben	(\$90 × 12 months) \$1,080	×	30%	\$324	\$324
Brad	(\$200 × 12 months) 2,400	×	30%	\$720	\$360
	<u>\$3,480</u>				
				Total credit	<u>\$684</u>

Slavedriver may take a \$684 Employer Child Care Contribution Credit on its California return using Form FTB 3501, **Employer Child Care Program/Contribution Credit**.

Slavedriver may also deduct \$3,480 as an employee benefit on its federal return. For California purposes, Slavedriver must reduce its employee benefit expense deduction by \$684, the amount of the credit.

### **Less than a full year**

If the duration of the child care received is fewer than 42 weeks, you must prorate the maximum credit using the ratio of the number of weeks of care received divided by 42 weeks.

### **Qualified employee**

A qualified employee is any employee of the taxpayer who is performing services for the taxpayer in California, within the meaning of R&TC §25133, during the period in which the qualified care is performed. The term “employee” also includes an individual who is an employee within the meaning of IRC § 401(c)(1), including self-employed individuals with no employees.

### **Big payoff for self-employed individuals**

One of the biggest benefits of the California credit is for a sole proprietor with young children. A self-employed individual is allowed the credit for child care provided to his or her own child(ren). The self-employed individual must offer the plan to all employees to be entitled to the credit. Thus, a Schedule C filer may establish a child care plan and pay the costs of child care for his or her own child(ren), even if there are no other employees. This self-employed individual may take the credit on the California return, even though the child care expenses are not deductible from the Schedule C.

Schedule C filers may also be entitled to claim the federal and state Child and Dependent Care Expenses Credit, using the expenses not claimed for the employer child care contribution credit.



## **Tax Planning**

### **Example of Employer Child Care Contribution Credit for Sole Proprietor**

Phil M. is a self-employed photographer with no employees. His six-year-old daughter, Philomena, goes to the YWCA each day after school so Phil can work. The YWCA charges \$300 per month, or \$3,600 per year. Phil establishes a qualified child care plan so that he can take the Employer Child Care Contribution Credit for the cost of Philomena's care. Phil gets a credit of \$360 (the lesser of \$360 or \$1,080 ( $\$3,600 \times 30\%$ )). Phil may also be entitled to claim the federal and state Child and Dependent Care Expenses Credit and, if he had employees, the federal credit for employer-provided child care facilities and services if he is under contract with the YWCA to provide child care services to his employees. Also, for California purposes, he may, if otherwise eligible, claim the California Child and Dependent Care Expenses Credit using the expenses he did not use to claim the Employer Child Care Contribution Credit.

### **Employee's salary reduction contributions do not qualify**

For taxable years beginning on or after January 1, 2001, "contributions" do not include amounts contributed to a qualified care plan pursuant to a salary reduction agreement to provide benefits under an IRC §129. However, this does not preclude a taxpayer from participating in an employer's dependent care assistance program (DCAP) (see example below). For taxable years beginning before January 1, 2001, payments made by the employer directly to the child care provider under a DCAP salary reduction agreement qualify as contributions for purposes of the credit.

**Example of DCAP with Employer  
Contribution Plan for Married Couple**

John and Gina are married with three small children who are in a qualified child care facility at a total cost of \$1,080 per month, or \$12,960 per year. John sets aside \$116.67 per month through his employer's DCAP, a flexible spending account. Gina's employer pays \$300 per month directly to the children's child care provider under her employer's child care contribution plan.

John is reimbursed \$1,400 ( $\$116.67 \times 12$ ) per year for child care expenses through his employer's DCAP; Gina is indirectly reimbursed \$3,600 ( $\$300 \times 12$ ) per year through her employer's child care contribution plan, for a total of \$5,000 (the maximum IRC §129(a)(2) income exclusion limit).

On John's W-2, \$1,400 shows up in Box 10, and \$3,600 shows up in Box 10 of Gina's Form W-2. The \$5,000 ( $\$1,400 + \$3,600$ ) dependent care benefits John and Gina received are fully excludable and must be reported on federal Form 2441 and Form FTB 3506, Child and Dependent Care Expenses. John and Gina may claim a federal and California (but California limits the credit to taxpayers with AGI less than \$100,000) Child and Dependent Care Expenses Credit based on the \$1,000 additional allowable qualified child and dependent care expenses (IRC §21). Also, Gina's employer qualifies for a \$1,080 ( $\$360 \times 12$ ) California Employer Child Care Contribution Credit. Tip: If John or Gina (or both) had self-employment income (or a loss), either or both could also claim a \$1,080 ( $\$360 \times 3$ ) California Employer Child Care Contribution Credit based on the remaining expenses of \$7,960 ( $\$12,960 - \$5,000$ ).

**Employer cannot reimburse employee**

Qualified contributions include only direct payments to child care programs or providers. Employer reimbursements to employees for their qualified care expenses do not qualify for the California Employer Child Care Contribution Credit.



**Tax Trap**

Employer reimbursements made directly to the employee do not qualify for the Employer Child Care Contribution Credit.

**California Employer Child Care Program Credit**

With California's Employer Child Care Program Credit, employers or commercial landlords leasing to employers may take a credit of 30 percent of the cost paid or incurred for establishing a child care program or constructing a child care facility in California for use primarily by the children of the employees or the children of the commercial tenants' employees, or both. They may also take a credit of 30 percent of the cost for amounts paid to California child care information and referral services that:

## *Child Care Plans: Big Breaks, Small Cost*

- identify local child care services;
- offer information describing these resources to employees; and
- refer employees to child care services where there are vacancies.

The maximum credit is \$50,000 in any given taxable year. Amounts in excess of \$50,000 may not be claimed and may not be carried forward. Like the Employer Child Care Contribution Credit, the Employer Child Care Program Credit is scheduled to sunset on January 1, 2007 (R&TC §§17052.17 and 23617).

### **Example of California limitation**

In 2002 Drop the LBs, Inc., modified its existing building to add a child care facility. They spent \$100,000 on the project. Their California Employer Child Care Program Credit for 2002 was \$30,000. However, due to tax liability limitations, they were able to use only \$10,000 of the credit on the 2002 return and carried over \$20,000 to 2003. In 2003 their new “Eat only orange food” diet sent their profits skyrocketing, and they added additional staff. They decided to expand and improve the child care facility, spending \$500,000 in qualified costs.

For the 2003 year, their tax liability was \$100,000. However, even though their tentative credit is \$170,000 ( $(\$500,000 \times 30\%) + \$20,000$  carryover), their credit is limited to \$50,000, and they may not carry over any of the remaining 2003 credit to 2004. Drop the LBs may also qualify for the federal credit for employer-provided child care facilities and services.

### **What costs qualify?**

The credit is for costs paid to establish a child care program or constructing a child care facility. Startup expenses include, but are not limited to:

- feasibility studies;
- site preparation; and
- construction, renovation, or acquisition of facilities for purposes of establishing or expanding on-site or near-site centers by one or more employers, or one or more building owners leasing space to employers.

The credit is not allowed for startup expenses used to establish a child care program or construct a child care facility in California for an owner of a commercial building who is required by local ordinance to provide a child care facility.

Employers may also claim the credit for contributions to California child care information and referral services that:

- identify local care services;
- offer information describing these resources to employees; and
- refer employees to child care services where there are vacancies.

## **Federal Credit for Employer-Provided Child Care Facilities**

For taxable years beginning on or after January 1, 2002, employers may claim a credit equal to 25 percent of the cost of qualified child care facility expenses, plus 10 percent of the qualified child care resource and referral expenses (IRC §45F). The maximum credit is \$150,000 per taxable year, and is subject to the general business credit limitations under IRC §38. You may carry any unused credit back one year, then forward up to 20 years. The taxpayer must reduce any business-related deductions and basis by the amount of the credit.

The credit is not allowed for the children of self-employed individuals. However, self-employed taxpayers may claim the credit on behalf of their employees' dependent children.

Qualified child care facility expenses include expenses paid or incurred for:

- acquiring, constructing, rehabilitating, or expanding property that is to be used as part of a qualified child care facility of the employer, is depreciable (or amortizable), and is not part of the employer's or any employee's principal resident.
- operating expenses of the facility, which include expenses for training employees, scholarship programs, and providing increased compensation to employees with higher levels of child care training.
- contracting with a qualified child care facility to provide child care services to the employees of the taxpayer. The credit is also available for constructing or operating a child care facility to be used by the employee's children. While the latter benefit is designed for larger employers, our smaller business clients may use the first benefit to their advantage.

A qualified care facility must meet all applicable state and local laws and regulations, including any licensing laws; and the principal use of the facility must be for child care (unless it is the principal residence of the person operating the facility). A facility is treated as a qualified child care facility if:

- it has open enrollment to the employees of the taxpayer;
- use of the facility (or eligibility to use such facility) does not discriminate in favor of highly compensated employees of the taxpayer (within the meaning of IRC §404(q)); and
- the facility is the principal trade or business of the taxpayer, and at least 30 percent of the children enrolled are dependents of the taxpayer's employees. (This requirement applies to facilities constructed and operated by the taxpayer, but not for services provided under a contract.)

## **Using State and Federal Credits Together**

The federal credit for employer-provided child care facilities and services and the California Employer Child Care Contribution Credit have differences. However, they both:

### *Child Care Plans: Big Breaks, Small Cost*

- allow a credit for payment of child care services at a child care facility. IRC §45F requires a “contract” with the facility. R&TC §§17052.18 and 23617.5 require the employer to make payment directly to the child care provider. To qualify for both credits, we suggest that the employer contract and make payments directly to the facility.
- require reduction of the allowable expense by the amount of the credit.
- fall within the meaning of IRC §129 for purposes of a DCAP, and as such, the contributions are excludable from the employee’s wages and are not subject to employment taxes. Amounts paid on behalf of the employee must be entered in Box 15 of the employee’s Form W-2.
- do not require that the employer pay 100 percent of the cost of the care.

As the example below shows, an employer will maximize the benefit by providing \$100 per month (\$1,200 per year) per child in child care payments.

#### **Example of Federal and California “Contribution” Credits**

Ben Savintax has one employee, Lott O. Kids. At the beginning of 2003, Ben contracts with the YMCA near Lott’s home to provide after-school care for Lott’s quadruplets. Ben contracts with the YMCA to pay \$100 per month per child to care for the children. In 2003 he pays \$4,800 to care for the four children (\$1,200 each). Assuming Ben is in the 35 percent federal tax bracket and 9.3 percent California bracket, Ben will reap these benefits:

Federal credit	$\$4,800 \times 25\% = \$1,200$	
Federal tax deduction	$(\$4,800 - \$1,200 \text{ (federal credit)}) \times 35\% = \$1,260$	
California Employer Child Care Contribution Credit	$\$4,800 \times 30\% = \$1,440$	
California deduction	$(\$4,800 - \$1,440 \text{ (California credit)}) \times 9.3\% = \$312$	
Cost of child care	\$4,800	
Tax savings	\$4,212	
Net out-of-pocket cost (the government pays almost 90 percent of Ben’s cost!)		\$588

The federal credit for employer-provided child care facilities and services and the California employer child care program credit also have differences. However, they both:

- allow a credit for qualified child care facility expenses, including acquisition, construction, and renovation.
- require reduction of the basis of the facility by the amount of the credit.
- allow a credit for qualified child care resource and referral services. IRC §45F requires a “contract” with the resource and referral service. R&TC §§17052.17 and 23617 require “contributions” to a California child care information and referral service. To qualify for both credits, we suggest that the employer contract with such a service.
- do not require that the employer pay 100 percent of the cost of the facility.

As the example below shows, an employer may claim both the state and federal credits.

**Example of Federal and California “Program” Credits**

Outel spent \$700,000 in 2002 and \$600,000 in 2003 constructing a child care facility for the children of its 500 employees in Folsom, California. Outel also contracted with a child care referral service for its employees and spent \$50,000 in 2003. Outel met all the requirements to qualify for both the federal and state Employer Child Care Program Credits. Outel’s tax liabilities prior to the credits are:

- Federal 2001 — \$40,000
- Federal 2002 — \$110,000
- State 2002 — \$10,000
- Federal 2003 — \$140,000
- State 2003 — \$15,000

Here’s how much Outel may claim in credits:

- 2002 federal credit for facilities is \$150,000 (lesser of \$150,000 or \$175,000 ( $\$700,000 \times .25$ )), so there is excess credit of \$40,000 ( $\$110,000 - \$150,000$ ), but Outel can carry it back to wipe out all of its 2001 tax liability.
- 2002 state Employer Child Care Program Credit is \$50,000 (lesser of \$50,000 or \$210,000 ( $\$700,000 \times .30$ )). However, the allowable amount is limited to \$10,000, the 2002 tax liability. The \$40,000 remainder is carried forward to 2003.
- 2003 federal credit is \$150,000, which is \$150,000 (lesser of \$150,000 or \$150,000 ( $\$600,000 \times .25$ )) for the facilities, plus the \$5,000 ( $\$50,000 \times .10$ ) in 2003 for the referral services with the \$150,000 overall cap. This wipes out all of Outel’s 2003 liability, and leaves a \$10,000 ( $\$150,000 - \$140,000$ ) carryover to 2004.
- 2003 state Employer Child Care Program Credit is \$50,000 (lesser of \$50,000 or \$195,000 [ $(\$600,000 \times .30) + (\$50,000 \times .30)$ ] plus \$40,000 carryover from 2002), which wipes out all of the state liability and leaves a \$75,000 ( $\$50,000 - \$15,000 + \$40,000$ ) carryover to 2004.

## Relationship with Child and Dependent Care Expenses Credit

### Child(ren) of self-employed taxpayers

Both state and federal law allow taxpayers to claim a credit for child and dependent care expenses if the taxpayer or spouse could work or look for work during the taxable year. To claim this credit, the taxpayer or spouse must have earned income and have child and dependent care expenses for a child under the age of 13. The California credit is refundable but is not available to taxpayers with a California AGI greater than \$100,000.

### California-only rules

A taxpayer may claim the California Employer Child Care Contribution Credit for payments made directly by the employer (the self-employed taxpayer, in this case) under a qualified care plan to care providers. You can then apply qualified expenses above those covered under the care plan toward the Child and Dependent Care Expenses Credit. Taxpayers may not use the same expenses for both credits. Self-employed taxpayers must determine what amounts were paid as an employer and what amounts were paid as an employee. They must then determine the applicable credits for each and claim the credits accordingly. Please note the differing age criteria — under age 13 for the Child and Dependent Care Expenses Credit, and under age 12 for the Employer Child Care Contribution Credit.

According to the FTB, the taxpayer claims the employee Child and Dependent Care Expenses Credit first and then uses any remaining expenses for the Employer Child Care Contribution Credit.

### Example of a Self-Employed Person with Two Children

Tren L. Agent is self-employed and has two children. He paid \$2,000 each to care for his children, Phoenix and Cheyenne. He has no other employees. His net Schedule C income is \$1,000, his wife's wages are \$50,000, and their AGI is \$70,000. Their California Child and Dependent Care Expenses Credit is \$200 ( $\$1,000 \times 20\%$ , using the lower earned income) and their California Child Care Contribution Credit is \$420.

The California Employer Child Care Contribution Credit is:

Expenses paid .....	\$4,000
Allowable expenses used for Child and Dependent Care Credit .....	( 1,000)
	\$3,000
	$\times .30$
	<u>\$ 900</u>
California Employer Child Care Contribution Credit (\$360 per child limit)	\$ 720

Employee taxpayers must reduce the qualified expenses used to calculate federal and California credits by any expenses paid under a child care reimbursement plan.

Differences between the California Employer Child Care Contribution Credit and the federal and California Child and Dependent Care Expenses Credits include:

- The child must be under the age of 12 for the Employer Child Care Contribution Credit, and under age 13 for the Child and Dependent Care Expenses Credit.



## *Child Care Plans: Big Breaks, Small Cost*

- The Employer Child Care Contribution Credit is only available for children, not for disabled spouses or other disabled dependents.
- For the Employer Child Care Contribution Credit, there is no earned income requirement; the spouse need not be employed. For purposes of the Child and Dependent Care Expenses Credit, with certain exceptions, the spouse also must be employed. Also, the self-employed spouse may have a net loss and still claim the employer child care credit.
- An employer must pay the expenses directly to the child care provider for purposes of the Employer Child Care Contribution Credit.
- The Child and Dependent Care Expenses Credit may not be carried over.
- The California Child and Dependent Care Expenses Credit is refundable.

## **Rules for Both California Employer Credits**

### **Reductions, recapture, and credit limits**

For purposes of the Employer Child Care Contribution Credit, a taxpayer must reduce any deduction for employer-provided child care expenses by the amount of the credit for California purposes. Also, when a taxpayer claims either the employer child care contribution or program credit, the taxpayer must reduce the depreciable basis by the amount of the credit in the taxable year the credit is allowed.

For purposes of the Employer Child Care Program Credit, if the taxpayer disposes of or stops operating the child care center within 60 months after completion, the taxpayer must recapture the portion of the credit claimed that represents the remaining portion of the 60-month period. The taxpayer must add the recapture amount to the tax liability in the taxable year of disposition or nonuse. Pass-through entities must identify the recapture amounts for their owners. There are no recapture provisions for the Employer Child Care Contribution Credit.

For purposes of the Employer Child Care Contribution Credit, if an employer makes contributions to a qualified care plan and also collects fees from parents to support child care facilities that the employer owns and operates, the contributions available for computing the credit may be limited. If the sum of the contributions and fees exceeds the total cost of the child care, the employer must reduce the contributions by the amount in excess of the cost.

S corporations may claim only one-third of the credit against the entity-level tax. The S corporation may carry over any unused portion of the one-third credit indefinitely. An S corporation may also pass through 100 percent (limited to \$50,000 annually at the S corporation level for purposes of the Employer Child Care Program Credit) of the credit to their shareholders.

Neither the Employer Child Care Contribution nor the Employer Child Care Program Credit can reduce the minimum franchise tax (C and S corporations), annual tax (limited partnerships, limited liability partnerships, and LLCs), AMT (all taxpayers), built-in gains tax, or the excess net passive investment income tax (S corporations). The credits may not reduce regular tax below tentative minimum tax, but may be carried over indefinitely.

## *Child Care Plans: Big Breaks, Small Cost*

### **Sharing the credit**

Two or more employers (other than a husband and wife) who share in the costs eligible for the credit may claim the credit in proportion to their respective share of the costs paid or incurred. When a husband and wife file separate returns, each spouse may take 50% of the credit or either spouse may claim the full credit.

### **Recapture of federal credit**

Like California's Employer Child Care Program Credit, federal law requires recapture of the acquisition and construction credit if there is a recapture event. There is no recapture required in the case of a casualty loss. A "recapture event" means:

- **Cessation of operation** — The facility no longer qualifies as a child care facility;
- **Change in ownership** — The taxpayer disposes or changes ownership of the facility. However, if the person acquiring the interest in the facility agrees in writing to assume the recapture liability of the person disposing of such interest, the recapture potential is assumed by the new person.

The recapture amount is a percentage based on:

- the applicable recapture percentage, and
- the aggregate decrease in the credits allowed under section 38 for all prior taxable years which would have resulted if the qualified child care expenditures of the taxpayer with respect to such facility had been zero.

The applicable percentage is determined from the following table:

If the recapture event occurs in:	The applicable recapture percentage is:
Years 1 – 3	100
Year 4	85
Year 5	70
Year 6	55
Year 7	40
Year 8	25
Years 9 – 10	10
Years 11 and thereafter	0

Year 1 begins on the first day of the taxable year in which the employer establishes the qualified child care program.

## Why Establish a Plan?

Depending on the facts and circumstances in your particular case, you may have additional benefits in the form of:

- lower self-employment taxes.
- lower payroll taxes.
- lower workers' compensation.
- lower pension costs.
- improved employee morale and attendance.
- greater productivity.
- fewer phone calls and lost time.
- better luck attracting and retaining qualified employees.

If you are self-employed and your dependent is under age 13, you may be able to use the full amount of the expenses — up to \$3,000 for each (\$6,000 maximum) (for taxable years beginning before 2003, \$2,400 for each (\$4,800 maximum)) of your own children — for the federal Child and Dependent Care Expenses Credit. Beginning in 2000, California also allows a refundable Child and Dependent Care Expenses Credit. If the child is under the age of 12, you may claim both credits, but you may not use the same expenses for both credits.

For taxable years beginning before January 1, 2001, employees' wages excluded through salary reduction under a qualified DCAP (IRC §129) or cafeteria plan (IRC §125) may qualify for the Employer Child Care Contribution Credit (FTB Notice 94-9 dated December 29, 1994) and employees can exclude up to \$5,000 per year in child care benefits from wages.

For DCAP (IRC §129), employers may deduct child care expenses for federal purposes (except expenses qualified for the federal credit) and expenses in excess of the California credits on the California return.

Employees benefit from a child care contribution plan because:

- they can acquire stable, reliable care for their children.
- they don't need to worry about child care, which causes a loss of work time and productivity.
- they will have fewer reasons to change jobs.
- the child care benefits are not subject to payroll and income taxes.

If the duration of an employee's child care is less than 42 weeks, an employer with a child care contribution plan must reduce the amount of the California credit by prorating the credit using the ratio of the number of weeks of care received divided by 42 weeks.

In most cases, you are not required to file federal Form 5500 for a child care plan (Notice 90-24, 1990-1 C.B. 335).

The following examples show the tax benefits that are available to a variety of small businesses that have a child care contribution plan. The examples use the 2001 rates, deductions,

**Child Care Plans: Big Breaks, Small Cost**

exemptions, etc. You should use this information as a guide only and research all applicable federal and state tax laws before establishing a plan.

**Example of Prorated Credit**

Lynn is an enrolled agent who has two employees who work from January 1 through April 15 each year. Each employee has one set of four-year-old twins who go to the Sweet Pea Child Care Center. The cost for their care is \$50 per week, or \$750 for 15 weeks, per child. Lynn pays the child care expenses to Sweet Pea on behalf of her employees. So, for the 15 weeks that the employees work, she pays \$3,000 (\$50 × 4 children × 15 weeks). Her employer child care credit is calculated as follows:

Amount paid per child .....	\$750
Credit percentage .....	× 30%
Credit per child (maximum \$360) .....	\$225
Number of children .....	× 4
Unprorated credit .....	\$900
Proration factor .....	× 15/42
Employer Child Care Contribution Credit .....	<u>\$321</u>

**Tax Saving Examples**

Note: The following examples do not include additional potential savings from the federal credit, nor potential savings from reduced employer payments of FICA, UI, or workers' compensation payments.

**Example of Self-Employed Individual with Employees and No Child Care Contribution Plan**

Mia is a self-employed individual with \$50,000 net business income and \$5,750 interest income in 2003. She is single with no dependents and takes the standard deduction. Mia has two employees who each have one dependent under the age of 12. Mia has no child care contribution plan.

	<b>Federal</b>	<b>California</b>
Net business income .....	\$50,000	\$50,000
Interest income .....	+ 5,750	+ 5,750
Total income .....	\$55,750	\$55,750
One-half of self-employment tax .....	- 3,533	- 3,533
Adjusted gross income .....	\$52,217	\$52,217
Standard deduction .....	- 4,750	- 3,070
Deduction for exemption(s) .....	- 3,050	
Taxable income .....	<u>\$44,417</u>	<u>\$49,147</u>
Tax .....	\$ 7,889	\$ 2,650
Self-employment tax .....	7,065	
Exemption credit(s) .....		- 82
Total tax .....	<u>\$14,954</u>	<u>\$ 2,568</u>
Total combined federal and state tax with no plan .....		<u>\$17,522</u>

*Child Care Plans: Big Breaks, Small Cost*

**Example of Self-Employed Individual with  
Employees and a Child Care Contribution Plan**

Had Mia had a child care contribution plan that pays \$100 per month for her two employees (\$2,400 per year) in the example above, here is what she would have saved in taxes in 2003:

	<b>Federal</b>	<b>California</b>
Net business income, exclusive of the child care expenses .....	\$50,000	\$50,000
Child care expenses .....	- 2,400	- 1,680 <sup>1</sup>
Net business income .....	\$47,600	\$48,320
Interest income .....	+ 5,750	+ 5,750
Total income .....	\$53,350	\$54,070
One-half of self-employment tax .....	- 3,363	- 3,363
Adjusted gross income .....	\$49,987	\$50,707
Standard deduction .....	- 4,750	- 3,070
Deduction for exemption(s) .....	- 3,050	
Taxable income .....	<u>\$42,187</u>	<u>\$47,637</u>
Tax .....	\$ 7,357	\$ 2,510
Self-employment tax .....	6,726	
Exemption credit(s) .....		- 82
Employer child care contribution credit .....		- 720
Total tax .....	<u>\$14,083</u>	<u>\$ 1,708</u>
Total combined federal and state tax with a plan .....		<u>\$15,791</u>

<sup>1</sup>\$2,400 of child care expenses less the \$720 Employer Child Care Contribution Credit.

Tax benefits of the California child care contribution plan (comparing Mia with no plan to Mia with a plan):

Mia's combined federal and state tax with no plan .....	\$17,522
Less: Mia's combined federal and state tax with a plan .....	<u>-15,791</u>
Tax benefits of having a plan (difference) .....	<u>\$ 1,731</u>

In the example with a plan, Mia had \$2,400 in expenses, but received a tax benefit totaling \$1,731. In other words, Mia received \$2,400 worth of child care services for \$609 (\$2,400 - \$1,791).

*Child Care Plans: Big Breaks, Small Cost*

**Example of Self-Employed Individual with No Employees and  
No Child Care Contribution Plan for His Own Dependents**

Steve is a self-employed individual with \$50,000 in net business income and \$5,750 in interest income in 2003. He is a single parent filing as head of household and takes the standard deduction. Steve has no employees, but does have two dependent children under the age of 12. He pays \$7,200 per year in child care costs and does not have a written child care contribution plan.

	<b>Federal</b>	<b>California</b>
Net business income .....	\$50,000	\$50,000
Interest income.....	+ 5,750	+ 5,750
Total income .....	<u>\$55,750</u>	<u>\$55,750</u>
One-half of self-employment tax.....	- 3,533	- 3,533
Adjusted gross income.....	<u>\$52,217</u>	<u>\$52,217</u>
Standard deduction.....	- 7,000	- 6,140
Deduction for exemption(s).....	- 9,150	
Taxable income.....	<u>\$36,067</u>	<u>\$46,077</u>
Tax.....	\$ 4,910	\$ 1,373
Self-employment tax.....	7,065	
Child and Dependent Care Expenses Credit.....	- 1,200	
Child Tax Credit.....	- 2,000	
Exemption credit(s) .....		- 596
Total tax .....	<u>\$8,775</u>	<u>\$ 777</u>
Total combined federal and state tax .....		<u>\$9,552</u>

*Child Care Plans: Big Breaks, Small Cost*

**Example of Self-Employed Individual with  
No Employees but with a Child Care Contribution Plan**

Had Steve had a child care contribution plan that pays \$100 per month for his two children (\$2,400 per year) in the example above, here is what he would have saved in taxes in 2003:

	<b>Federal</b>	<b>California</b>
Net business income .....	\$50,000	\$50,000
Interest income.....	+ 5,750	+ 5,750
Total income .....	<u>\$55,750</u>	<u>\$55,750</u>
One-half of self-employment tax.....	- 3,533	- 3,533
Adjusted gross income.....	<u>\$52,217</u>	<u>\$52,217</u>
Standard deduction .....	- 7,000	- 6,140
Deduction for exemption(s).....	- 9,150	
Taxable income.....	<u>\$36,067</u>	<u>\$46,077</u>
Tax .....	\$ 4,910	\$ 1,373
Self-employment tax.....	7,065	
Child and Dependent Care Expenses Credit.....	- 1,200	
Child Tax Credit.....	- 2,000	
Exemption credit(s) .....		- 596
Employer Child Care Contribution Credit.....		- 720
Total tax .....	<u>\$8,775</u>	<u>\$ 57</u>
Total combined federal and state tax .....		<u>\$8,832</u>

Tax benefits of the child care contribution plan (comparing Steve with no plan to Steve with a plan):

Steve's combined federal and state tax with no plan.....	\$9,552
Less: Steve's combined federal and state tax with a plan .....	- 8,832
Tax benefits of having a plan (difference).....	<u>\$ 720</u>

In the example with a plan, Steve saved \$720 in taxes simply by setting up a child care contribution plan.

**Example of Corporation with No Child Care Contribution Plan**

A California corporation has \$450,000 in federal and California taxable income and no child care contribution plan. The corporation's employees have a total of 20 dependents under the age of 12.

	<b>Federal</b>	<b>California</b>
Taxable income.....	<u>\$450,000</u>	<u>\$450,000</u>
Total tax .....	<u>\$153,000</u>	<u>\$ 39,780</u>
Total combined federal and state tax with no plan .....		<u>\$192,780</u>

**Child Care Plans: Big Breaks, Small Cost**

**Example of Corporation with a Child Care Contribution Plan**

A California corporation has \$450,000 in federal and California taxable income before the deduction of child care expenses. The corporation has a written DCAP that pays \$100 per month for each employee's dependent under the age of 12. During the year, the corporation pays \$24,000 in child care costs for 20 dependents.

	<b>Federal</b>	<b>California</b>
Original taxable income, exclusive of the child care expenses ...	\$450,000	\$450,000
Child care expenses .....	- 24,000	- 16,800 <sup>1</sup>
Taxable income .....	<u>\$426,000</u>	<u>\$433,200</u>
Tax .....	144,840	\$ 38,295
Employer Child Care Contribution Credit (\$360 × 20).....	<u>                    </u>	<u>- 7,220</u>
Total tax .....	<u>\$144,840</u>	<u>\$ 31,095</u>
Total combined federal and state tax .....	<u>\$175,935</u>	

<sup>1</sup>\$24,000 of child care expense less the \$7,200 Employer Child Care Contribution Credit.

Tax benefits of the child care contribution plan (compared to the corporation example without a plan)	
The corporation example without a plan, combined federal and state tax.....	\$192,780
Less: The corporation example with a plan, combined federal and state tax .....	<u>- 175,935</u>
Tax benefits of having a plan (difference).....	<u>\$ 16,845</u>

In this example, the taxpayer had \$24,000 in expenses, but received a tax benefit totaling \$16,845. So the taxpayer's true out-of-pocket cost is \$7,155 (\$24,000 - \$16,845), exclusive of any employment tax savings. In addition, if the plan is a qualified salary reduction plan, employee contributions qualify for the credit as long as the employer pays the child care provider directly. In this case, any employee contributions are also excluded from the employee's wages, reducing the employee's taxable income, as well as the employer's and the employee's employment tax liabilities.



**Example of Employer Child Care Program Credit (Single Employer)**

Luvyourkids, Inc., spent \$1,000,000 in 2002 in qualified start-up expenses for preparation for a new child care facility that its employees could use for their children. Luvyourkids's 2002 federal tax liability is \$200,000, and the state tax liability is \$10,000 (after applying all other available credits). Luvyourkids may claim a federal employer-provided child care facilities credit of \$150,000 (lesser of  $.25 \times \$1,000,000$ , or \$150,000) and a California Employer Child Care Program Credit of \$50,000 (lesser of  $.30 \times \$1,000,000$ , or \$50,000) in 2002. Luvyourkids may carry over \$40,000 of the state credit to the 2003 taxable year and must pay only the \$800 minimum franchise tax for the 2002 taxable year.

Luvyourkids's 2003 federal tax is \$20,000 and the state tax liability is \$50,000 (after all other available credits). In 2003 Luvyourkids spent an additional \$100,000 in qualified start-up expenses, generating a federal employer-provided child care facilities credit of \$25,000 (lesser of  $.25 \times \$100,000$ , or \$150,000) and a state Employer Child Care Program Credit of \$30,000 (lesser of  $.30 \times \$100,000$ , or \$50,000) for the 2003 taxable year. Luvyourkids may carry back the excess federal credit of \$5,000 ( $\$25,000 \text{ credit} - \$20,000 \text{ liability}$ ) to the 2002 taxable year and add the \$40,000 state credit carryforward from 2002 to the \$30,000 credit for 2003 for a total tentative state credit of \$70,000. Luvyourkids must apply the \$50,000 state credit limit and use the \$50,000 state credit to reduce its 2003 tax liability to zero (except for the \$800 minimum franchise tax). Luvyourkids may not carry over the excess \$20,000 of the state credit to the 2004 taxable year because the credit is limited to \$50,000 for any given year.

**Example of Employer Child Care Program Credit (Multiple Employers)**

Three California employers — Tom, Inc.; Dick, Inc.; and Harry, Inc. — decided to jointly construct a child care facility to be used primarily by their employees' dependent children. Because Tom, Dick, and Harry each had a different number of employees, they allocated the costs in proportion to the number of children who would be served. Tom, Inc., paid 25 percent of the costs; Dick, Inc., paid 30 percent of the costs; and Harry, Inc., paid 45 percent of the costs. The start-up costs of constructing the facility were \$150,000 in 2002 and \$100,000 in 2003. The Employer Child Care Program Credit — 30 percent of the costs paid or incurred — is allocated as follows:

	<u>2002</u>	<u>2003</u>	<u>Total Credit</u>
Tom, Inc. ....	\$11,250 <sup>1</sup>	\$ 7,500	\$18,750
Dick, Inc. ....	13,500	9,000	22,500
Harry, Inc. ....	<u>+20,250</u>	<u>+13,500</u>	<u>+33,750</u>
	<u>\$45,000</u>	<u>\$30,000</u>	<u>\$75,000</u>

<sup>1</sup> $[\$150,000 \times 30\%] \times 25\%$

**NOTE:** After the facility is constructed and operational, Tom, Dick, and Harry can also qualify for the Employer Child Care Contribution Credit of up to \$360 for each employee dependent under the age of 12 and deduct the expenses in excess of the credit as an ordinary and necessary business expense. The company may also qualify for the federal credit for Employer-Provided Child Care Facilities and Services Credit.

*Child Care Plans: Big Breaks, Small Cost*

## Sample Letter Explaining Employer Child Care Credits

Dear \_\_\_\_\_

As a California business, we want to notify you of two of the most generous tax credits in California. Not only do you get a substantial tax break, but these credits have the side effect of improving employee productivity and morale. There is also a lucrative federal credit available for a potentially significant portion of the same costs.

### Two California Tax Credits

1. California allows a nonrefundable tax credit of 30 percent of the cost — **up to \$360 per year per child** — if you pay for child care expenses for your employees' dependents under the age of 12.

This credit — called the Employer Child Care Contribution Credit — is available to all types of businesses, including corporations, partnerships, trusts and estates, and sole proprietors. Some other benefits are:

- Certain cafeteria plans and dependent care assistance programs (DCAP) qualify.
  - Your expenses in excess of the credit may be deductible.
  - You can carry over any unused credits.
  - If you are self-employed, the child care expenses for your own children may qualify — **and you can still take the federal and state Child and Dependent Care Expenses Credit if you qualify.**
2. The Employer Child Care Program Credit equals 30 percent of the start-up costs — **up to a \$50,000 credit per year** — if you establish a child care facility for your employees' dependents, or if you are a building owner who leases space to an employer or business. The credit is nonrefundable, but you can carry over any unused credit.

With some adjustments, you may also qualify for a 25 percent federal credit.

### Federal and California Payroll Tax Savings

Besides the tax credits, there are other immediate financial benefits to an employer who has a child care contribution plan or incurs start-up costs for a program. An employer may actually **reduce payroll taxes and workers' compensation insurance.** If the plan is in writing, the employer may also qualify for some federal tax benefits.

If you are providing child care benefits to your employees — or are thinking about providing them — please give us a call so we can make sure that you get all of the tax breaks you so rightfully deserve.

Sincerely yours,

# Child Care Contribution Plan of

\_\_\_\_\_  
(Company Name)

\_\_\_\_\_ organized under the laws of the State of California,  
(Company Name)  
(hereafter referred to as “the Employer”) hereby establishes this Child Care Contribution Plan,  
(hereafter referred to as “the Plan”), for the benefit of its employees and their dependents.

1. Effective \_\_\_\_\_, \_\_\_\_\_, the Employer will contribute on  
(Month) (Day) (Year)  
behalf of any employee who is at least \_\_\_\_\_ years old and who has been employed  
by the Employer for at least \_\_\_\_\_ for certain dependent child care  
expenses incurred to allow the employee to work for the Employer.
2. The child care expenses must be incurred during the time the employee is working for the  
Employer, plus up to a half hour before and after work.
3. The employee must be employed on a full-time basis. For purposes of this Plan, an  
employee will be considered to be employed full-time during any month he/she works an  
average of at least \_\_\_\_\_ hours per week, including authorized holidays and vacations.
4. The dependent child(ren) for whom the care is provided must be under the age of 12 years.
5. Contributions are not available if the care provided on behalf of an employee’s dependent  
child(ren) is provided by a person who:
  - A. Qualifies as a dependent of that employee or that employee’s spouse; or
  - B. Is a son, stepson, daughter, or stepdaughter of that employee and is under the age of 19  
at the close of the year.
6. The child care provider must be located in California and be licensed, if required by state law.
7. The Employer must make all payments directly to the child care program or provider. The  
employee must submit an invoice from the child care provider or program, and the Employer  
must pay the provider or program on a monthly basis. The employee must also provide the  
Employer with the provider’s or program’s taxpayer identification number or Social  
Security number, unless the provider or program is a corporation. The Employer will not  
issue payment without a completed Form W-9.
8. The amount of reimbursement is limited to \$ \_\_\_\_\_ per month per qualified  
dependent child for whom care is provided.

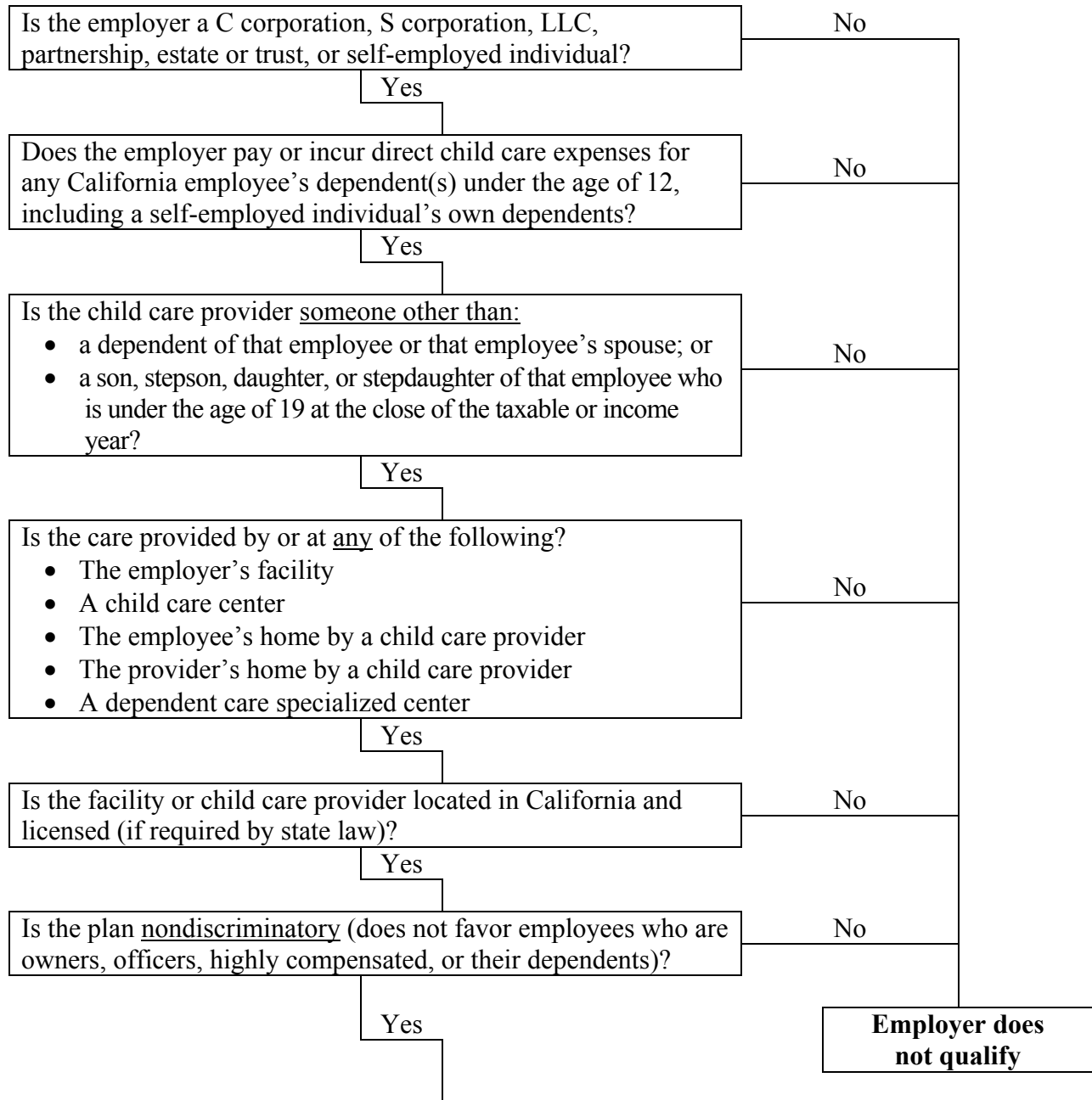
\_\_\_\_\_  
President

\_\_\_\_\_  
(Company Name)

**NOTE:** This is not a salary reduction plan.

## Flow Chart to Determine California Employer Child Care Contribution Credit

California allows a credit of up to \$360 per dependent for employers who provide child care assistance for their employee's dependents under the age of 12. This flow chart will help you easily determine if you or your client qualify for this very liberal credit.

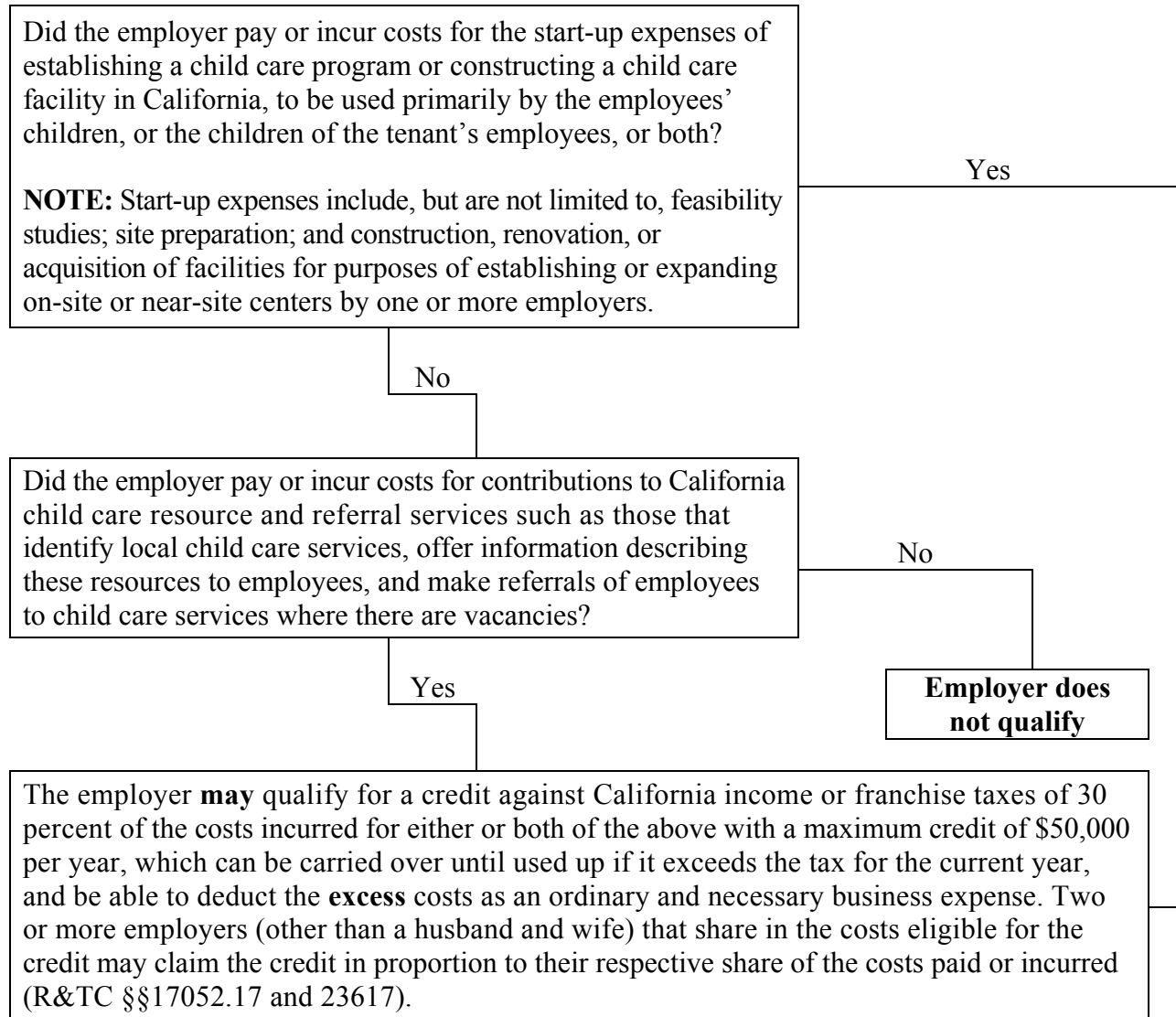


*Child Care Plans: Big Breaks, Small Cost*

The employer **may** qualify for a credit against California income or franchise taxes of 30 percent of the employer's cost (contribution), up to a maximum credit of \$360 per dependent per year, carry over any unused credits until used up, and be able to deduct the **excess** costs as an ordinary and necessary business expense (R&TC §§17052.18 and 23617.5).

## Flow Chart to Determine California Employer Child Care Program Credit

California allows a credit of 30 percent of the cost — with a maximum credit of \$50,000 per year — for employers who incur start-up expenses for establishing a child care program or constructing a child care facility in California, or for child care information and referral services.



*Child Care Plans: Big Breaks, Small Cost*



# Contract to Provide Child Care Services

## Between ABC Corp. (“Employer”) and XYZ Corp (“Child Care Provider”)

“Employer” has an employer child care program qualified under IRC §45F and R&TC §§17052.18 and 23617. Under this plan, “Employer” will pay a portion of the child care costs for children of eligible employees.

The purpose of this contract is to pay to “Child Care Provider” (a maximum dollar per child as listed below) of cost of child care services that would otherwise be paid by “Employer’s” employees by authorizing the Child Care Provider to bill “Employer” up to:

\$ \_\_\_\_\_ per month per named child (“Named Children”) for providing child care services for the child.

Any additional charges shall be the sole responsibility of the employee (parent) and shall not be the responsibility of Employer.

This contract can be terminated by the Employer at any time by providing notice to the Child Care Provider that it will no longer be paying for any subsequent services for any children or it can be amended from time to time to change the list of children to take into account new employees, ones who have left the employee of the Employer or changes to the Employer’s child care plan.

This contract is not intended to affect any contract between “Child Care Provider” and the employee or the children of the employee, except as to the payments listed above.

Child Care Provider represents that it is a facility:

9. The principal use of which is to provide child care assistance (or the facility is the child care provider’s principal residence, within the meaning of IRC §121, and
10. Which meets 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 (if licensing is required).

---

Employer	Date	Address	Federal ID #
----------	------	---------	--------------

---

Child Care Provider	Date	Address	Federal ID #
---------------------	------	---------	--------------

*Child Care Plans: Big Breaks, Small Cost*

**Named Children as of \_\_\_ / \_\_\_ / 200\_\_**

**Parent's Name**

1. \_\_\_\_\_
2. \_\_\_\_\_
3. \_\_\_\_\_
4. \_\_\_\_\_
5. \_\_\_\_\_
6. \_\_\_\_\_
7. \_\_\_\_\_
8. \_\_\_\_\_
9. \_\_\_\_\_
10. \_\_\_\_\_
11. \_\_\_\_\_
12. \_\_\_\_\_
13. \_\_\_\_\_
14. \_\_\_\_\_
15. \_\_\_\_\_
16. \_\_\_\_\_
17. \_\_\_\_\_
18. \_\_\_\_\_
19. \_\_\_\_\_
20. \_\_\_\_\_

1. \_\_\_\_\_
2. \_\_\_\_\_
3. \_\_\_\_\_
4. \_\_\_\_\_
5. \_\_\_\_\_
6. \_\_\_\_\_
7. \_\_\_\_\_
8. \_\_\_\_\_
9. \_\_\_\_\_
10. \_\_\_\_\_
11. \_\_\_\_\_
12. \_\_\_\_\_
13. \_\_\_\_\_
14. \_\_\_\_\_
15. \_\_\_\_\_
16. \_\_\_\_\_
17. \_\_\_\_\_
18. \_\_\_\_\_
19. \_\_\_\_\_
20. \_\_\_\_\_

Employer Child Care Program/ Contribution Credit

Attach to your California tax return.

Social security, Corporation no., or FEIN

Name(s) as shown on return

Secretary of State (SOS) file number

Part I Employer Child Care Program Credit. Read the instructions before completing this part.

Section A

1 Number of children the child care facility(ies) will legally accommodate (no minimum number required) 1

Section B - Credit Computation

Table with 15 rows for credit computation. Rows 5-10 are shaded. Includes instructions for lines 2-15 regarding startup expenses, contributions, and carryovers.

Section C - Credit Recapture (for the Employer Child Care Program Credit). See General Information, Part I, E, Recapture

Table for credit recapture with columns (a) Total credit claimed for all years, (b) Proration percentage, and (c) Credit recapture amount. Row 16 is the final calculation row.

Include the amount on line 16, column (c), in the total on: Form 540, line 36; Long Form 540NR, line 45; Form 541, line 32; Form 100, Schedule J, line 5; Form 100S, Schedule J, line 5; Form 100W, Schedule J, line 5; Form 109, Schedule K, line 4; Form 565, Schedule K, line 22; or Form 568, Schedule K, line 22. In the space to the left of the line, write "FTB 3501" and the amount of credit recaptured.

Part II Employer Child Care Contribution Credit. Read the instructions before completing this part.

Table for Employer Child Care Contribution Credit with 8 rows. Columns include employee name, contribution amount, 30% of contribution (max \$360), weeks of care, and credit amount.

# Instructions for Form FTB 3501

## Employer Child Care Program/Contribution Credit

### General Information

The Employer Child Care Program Credit and the Employer Child Care Contribution Credit are extended to taxable years beginning before January 1, 2007.

Employer contributions **do not** include amounts contributed to a qualified care plan pursuant to a salary reduction agreement. See Part II, Employer Child Care Contribution Credit, C Definitions.

### Purpose

Use form FTB 3501 to figure a credit if you are an employer and have established or contributed to a qualified employee child care program, constructed a child care facility in California, or contributed to California child care information and referral services.

Also, use form FTB 3501 to figure any recapture of the employer child care program credit and to claim pass-through employer child care program/contribution credits received from S corporations, estates or trusts, partnerships, or limited liability companies (LLCs) classified as partnerships.

S corporations, estates or trusts, partnerships, and LLCs classified as partnerships should complete form FTB 3501 to figure the credit to pass through to shareholders, beneficiaries, partners, or members. Attach this form to Form 100S, Form 541, Form 565, or Form 568. Show the pass-through credit for each shareholder, beneficiary, partner, or member on Schedule K-1 (100S, 541, 565, or 568).

### Part I — Employer Child Care Program Credit

#### A Description

The amount of the credit allowed is 30% of costs you paid or incurred for establishing a child care program, or constructing a child care facility in California for use primarily by the children of your employees, the children of your tenants' employees, or both.

Two or more employers (other than a husband and wife) who share in the costs eligible for the credit may claim the credit in proportion to their respective share of the costs paid or incurred. When a husband and wife file separate returns, either spouse may claim the credit or each may claim half (50%) of the credit.

#### B Qualifications

##### Child Care Program Startup

You may claim this credit if you paid or incurred costs for the startup expenses of establishing a child care program or constructing child care facilities in California, and you either:

- Are an employer; or
- Own commercial or office space that you lease to an employer.

##### Information and Referral Services

You may also claim a credit for contributions to California child care information and referral services that:

- Identify local child care services;
- Offer information describing these resources to employees; and
- Refer employees to child care services where there are vacancies.

If a child care facility is established by two or more employers, the credit is allowed if the facility is to be used primarily by the children of the employees of each of the employers or the children of the employees of tenants of each of the taxpayers, or both.

**Note:** A credit is not allowed for the startup expenses of establishing a child care program or constructing a child care facility in California for an owner of a commercial building who is required by local ordinance to provide a child care facility.

#### C Definition of Startup Expenses

Startup expenses include, but are not limited to:

- Feasibility studies;
- Site preparation; and
- Construction, renovation, or acquisition of facilities for purposes of establishing or expanding on-site or near-site centers by one or more employers, or one or more building owners leasing space to employers.

#### D Limitations

The amount of credit generated for any taxable year is limited to \$50,000 (form FTB 3501, Part I, line 7). Any credit amount in excess of \$50,000 may not be claimed and cannot be carried over to succeeding years.

S corporations may claim only 1/3 of the credit against the 1.5% entity-level tax (3.5% for financial S corporations). Any of the 1/3 credit not used by the S corporation in the year it was generated can be carried over to succeeding years until exhausted. In addition, S corporations can pass through 100% (limited to \$50,000 annually at the S corporation level) of the credit to their shareholders.

If a taxpayer owns an interest in a disregarded business entity (a single member LLC [SMLLC] not recognized [disregarded] by California and for tax purposes treated as a sole proprietorship owned by an individual or a branch owned by a corporation), the credit amount received from the disregarded entity that can be utilized is limited to the difference between the taxpayer's regular tax figured with the income of the disregarded entity, and the

taxpayer's regular tax figured without the income of the disregarded entity.

An SMLLC may be disregarded as an entity separate from its owner, and is subject to statutory provisions that recognize otherwise disregarded entities for certain tax purposes.

Get Form 568, Limited Liability Company Return of Income tax booklet, for more details.

**Note:** If the disregarded entity reports a loss, the taxpayer may not claim the credit this year, but can carry over the credit amount received from the disregarded entity.

This credit cannot reduce the minimum franchise tax (corporations and S corporations), the annual tax (limited partnerships, limited liability partnerships, and LLCs), the alternative minimum tax (corporations, exempt organizations, individuals, and fiduciaries), the built-in gains tax (S corporations), or the excess net passive income tax (S corporations). This credit cannot reduce regular tax below the tentative minimum tax (TMT). See Schedule P (100, 100W, 540, 540NR, or 541) for more information.

This credit is taken in lieu of any deduction otherwise allowable for the same costs. Therefore, any deduction allowed for the same costs or contributions must be reduced by the amount of credit claimed for the current taxable year (the amount shown on form FTB 3501, Part I, line 12).

The amount of credit you can claim on your tax return may be limited further (in addition to the annual limitation). Refer to the credit instructions in your tax booklet for more information. These instructions also explain how to claim this credit on your tax return. You must use credit code number **189** when you claim this credit.

**Note:** This credit is not refundable.

#### Corporate Members of a Unitary or Combined Group

This credit cannot be allocated or otherwise transferred to another taxpayer, even if the other taxpayer is a member of a unitary or combined group or otherwise affiliated with the taxpayer that earned the credit.

#### E Recapture

If the child care center is disposed of or stops operating within 60 months after completion, the portion of the credit claimed that represents the remaining portion of the 60-month period must be recaptured. You must add the recapture amount to your tax liability in the taxable year of disposition or nonuse. Figure any recapture amount in Part I, Section C.

Estates or trusts, partnerships, and LLCs classified as partnerships must identify the recapture amounts for their beneficiaries,

partners, and members on Schedule(s) K-1 (541, 565, or 568). In addition, S corporations must identify recapture amounts for their shareholders on Schedule K-1 (100S), which will differ from the amount recaptured by the S corporation on Form 100S, Schedule J, line 5.

## F Carryover

If the available credit exceeds your tax liability for the current taxable year, you may carry over the excess credit to succeeding years until exhausted.

If the available credit generated this year (limited to \$50,000) plus the credit carried over from a prior year, if any, exceeds \$50,000, you may carry over the amount in excess of \$50,000 to succeeding years.

Apply the carryover to the earliest taxable year(s) possible. In no event can this credit be carried back and applied against a prior year's tax.

## G Basis and Depreciation

You must reduce the depreciable basis of the child care facility(ies) by the amount of the credit attributable to the facility(ies) in the taxable year the credit is allowed. You may elect to take depreciation in lieu of this credit, or you may depreciate the cost of the facility(ies) that exceeds the amount of the credit claimed.

## Part II — Employer Child Care Contribution Credit

### A Description

The amount of the credit allowed is 30% of costs you paid or incurred for contributions made to a qualified care plan on behalf of any of your California employees' dependents under the age of 12.

Two or more employers (other than a husband and wife) who share in the costs eligible for the credit may claim the credit in proportion to their respective share of the costs paid or incurred. When a husband and wife file separate returns, either spouse may claim the credit or each may claim half (50%) of the credit.

### B Qualifications

You may claim this credit if you are an employer who made contributions to a qualified care plan for any of your California employees' dependents under the age of 12.

For purposes of this credit, self-employed individuals may also claim this credit if they make contributions to a qualified care plan for their dependents under the age of 12.

The credit is not available if the employee's dependent is in the care of a person who:

- Qualifies as a dependent of that employee or that employee's spouse; or

- Is a son, stepson, daughter, or stepdaughter of that employee and is under the age of 19 at the close of the taxable year.

## C Definitions

**Qualified care plan** includes, but is not limited to:

- On-site service;
- Center-based service;
- In-home care;
- Home-provider care; or
- Dependent care specialized center.

Facilities must be located in California and operated under the authority of a license when required by state law.

Employer contributions include direct payments to child care programs or providers. Employer contributions **do not** include amounts contributed to a qualified care plan pursuant to a salary reduction agreement.

## D Limitations

The amount of this credit cannot exceed \$360 per dependent in any taxable year.

If the child care received is less than 42 weeks, prorate the credit as indicated in Part II, line 1, column (d).

If you, as an employer, make contributions to a qualified care plan and also collect fees from parents to support child care facilities that you own and operate, the contributions available for figuring the allowable credit may be limited. If the sum of contributions and fees exceeds the total cost of child care, the contributions must be reduced by the amount in excess of cost.

S corporations may claim only 1/3 of the credit against the 1.5% entity-level tax (3.5% for financial S corporations). Any of the 1/3 credit not used by the S corporation in the year it was generated can be carried over to succeeding years until exhausted. In addition, S corporations can pass through 100% (limited to \$360 annually at the S corporation level) of the credit to their shareholders.

If a taxpayer owns an interest in a disregarded business entity, the credit amount received from the disregarded entity that can be utilized is limited. The limitation is the difference between the taxpayer's regular tax figured with the income of the disregarded entity, and the taxpayer's regular tax figured without the income of the disregarded entity.

**Note:** If the disregarded entity reports a loss, the taxpayer may not claim the credit this year, but can carry over the credit amount received from the disregarded entity.

This credit cannot reduce the minimum franchise tax (corporations and S corporations), the annual tax (limited partnerships, limited liability partnerships, and LLCs), the alternative minimum tax (corporations, exempt organizations, individuals, and fiduciaries), the built-in gains tax (S corporations), or the excess net passive income tax

(S corporations). This credit cannot reduce regular tax below TMT. See Schedule P (100, 100W, 540, 540NR, or 541) for more information.

This credit is taken in lieu of any deduction otherwise allowable for the same costs. Therefore, any deduction allowed for the same costs or contributions must be reduced by the amount of credit claimed for the current taxable year (the amount shown on Part II, line 7).

The amount of this credit you can claim on your tax return may be limited further. Refer to the credit instructions in your tax booklet for more information. These instructions also explain how to claim this credit on your tax return. You must use credit code number **190** when you claim this credit.

**Note:** This credit is not refundable.

## Corporate Members of a Unitary or Combined Group

This credit cannot be allocated or otherwise transferred to another taxpayer, even if the other taxpayer is a member of a unitary or combined group or otherwise affiliated with the taxpayer that earned the credit.

## E Carryover

If the available credit exceeds your tax liability for the current taxable year, you may carry over the excess credit to succeeding years until exhausted.

Apply the carryover to the earliest taxable year(s) possible. In no event can this credit be carried back and applied against a prior year's tax.

## F Basis

When you claim this credit for contributions to a qualified care plan used at a facility(ies) that you own, reduce the depreciable basis of the facility(ies) by the amount of the credit in the taxable year the credit is allowed.



# Credit for Employer-Provided Childcare Facilities and Services

▶ Attach to your tax return.

Name(s) shown on return

Identifying number

## Part I Current Year Credit (Members of controlled groups or businesses under common control, see instructions.)

1	Qualified childcare facility expenditures paid or incurred (see instructions)				
2	Enter 25% (.25) of line 1				
3	Qualified childcare resource and referral expenditures paid or incurred				
4	Enter 10% (.10) of line 3				
5	Form 8882 credits from pass-through entities (if more than one entity, see instructions):				
	If you are a—	Then enter the total of the current year credits from—			
a	Shareholder	Schedule K-1 (Form 1120S), lines 12d, 12e, or 13			} ----- EIN of pass-through entity
b	Partner	Schedule K-1 (Form 1065), lines 12c, 12d, or 13			
c	Beneficiary	Schedule K-1 (Form 1041), line 14			
6	Add lines 2, 4, and 5				
7	<b>Current year credit.</b> Enter the <b>smaller</b> of line 6 or <b>\$150,000</b> (S corporations, partnerships, estates, and trusts, see instructions)				

## Part II Allowable Credit (See Who must file Form 3800 to find out if you complete Part II or file Form 3800.)

8	Regular tax before credits:				
	• Individuals. Enter the amount from Form 1040, line 41	}			8
	• Corporations. Enter the amount from Form 1120, Schedule J, line 3; or the applicable line of your return				
	• Estates and trusts. Enter the sum of the amounts from Form 1041, Schedule G, lines 1a and 1b, or the amount from the applicable line of your return				
9	Alternative minimum tax:				
	• Individuals. Enter the amount from Form 6251, line 35	}			9
	• Corporations. Enter the amount from Form 4626, line 14				
	• Estates and trusts. Enter the amount from Form 1041, Schedule I, line 56				
10	Add lines 8 and 9				
11a	Foreign tax credit		11a		11m
b	Credit for child and dependent care expenses (Form 2441, line 11)		11b		
c	Credit for the elderly or the disabled (Schedule R (Form 1040), line 24)		11c		
d	Education credits (Form 8863, line 18)		11d		
e	Credit for qualified retirement savings contributions (Form 8880, line 14)		11e		
f	Child tax credit (Form 1040, line 49)		11f		
g	Mortgage interest credit (Form 8396, line 11)		11g		
h	Adoption credit (Form 8839, line 18)		11h		
i	District of Columbia first-time homebuyer credit (Form 8859, line 11)		11i		
j	Possessions tax credit (Form 5735, line 17 or 27)		11j		
k	Credit for fuel from a nonconventional source		11k		
l	Qualified electric vehicle credit (Form 8834, line 20)		11l		
m	Add lines 11a through 11l				
12	Net income tax. Subtract line 11m from line 10. If zero, skip lines 13 through 16 and enter -0- on line 17				
13	Net regular tax. Subtract line 11m from line 8. If zero or less, enter -0-		13		12
14	Enter 25% (.25) of the excess, if any, of line 13 over \$25,000 (see instructions)		14		
15	Tentative minimum tax (see instructions):				15
	• Individuals. Enter the amount from Form 6251, line 33	}			
	• Corporations. Enter the amount from Form 4626, line 12				
	• Estates and trusts. Enter the amount from Form 1041, Schedule I, line 54				
16	Enter the greater of line 14 or line 15				
17	Subtract line 16 from line 12. If zero or less, enter -0-				
18	<b>Credit allowed for the current year.</b> Enter the <b>smaller</b> of line 7 or line 17 here and on Form 1040, line 52; Form 1120, Schedule J, line 6d; Form 1120-A, Part I, line 2a; Form 1041, Schedule G, line 2c; or the applicable line of your return. If line 17 is smaller than line 7, see instructions				





## General Instructions

Section references are to the Internal Revenue Code.

### Purpose of Form

Employers use Form 8882 to claim the credit for qualified childcare facility and resource and referral expenditures. The credit is part of the general business credit. You may claim the credit any time within 3 years from the due date of your return on either an original or amended return.

### How To Figure the Credit

The credit is 25% of the qualified childcare facility expenditures plus 10% of the qualified childcare resource and referral expenditures paid or incurred during the tax year. The credit is limited to \$150,000 per tax year.

**Qualified childcare facility expenditures** are amounts paid or incurred:

- To acquire, construct, rehabilitate, or expand property that:
  1. Is to be used as part of a qualified childcare facility of the taxpayer,
  2. Is depreciable (or amortizable) property, **and**
  3. Is not part of the principal residence of the taxpayer or any employee of the taxpayer;
- For the operating expenses of a qualified childcare facility of the taxpayer, including expenses for training of employees, scholarship programs, and providing increased compensation to employees with higher levels of childcare training; or
- Under a contract with a qualified childcare facility to provide childcare services to employees of the taxpayer.

**Note:** Any expenses for childcare included in qualified childcare facility expenditures may not exceed the fair market value of such care.

A **qualified childcare facility** is a facility that meets 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 childcare facility. The following conditions must also be met.

- The principal use of the facility must be to provide childcare (unless the facility is also the personal residence of the person operating the facility).
- Enrollment in the facility must be open to employees of the taxpayer during the tax year.
- If the facility is the principal trade or business of the taxpayer, at least 30% of the enrollees of the facility must be dependents of employees of the taxpayer.
- The use of the facility (or the eligibility to use the facility) must not discriminate in favor of highly compensated employees.

**Qualified childcare resource and referral expenditures** are amounts paid or incurred under a contract to provide childcare resource and referral services to employees of the taxpayer. The provision of the services (or the eligibility to use the services) must not discriminate in favor of highly compensated employees.

### No Double Benefit Allowed

You must reduce:

- The basis of any qualified childcare facility by the amount of the credit on line 7 allocable to capital expenditures related to the facility,
- Any otherwise allowable deductions used to figure the credit by the amount of the credit on line 7 allocable to those deductions, and
- Any expenditures used to figure any other credit by the amount of the credit on line 7 allocable to those expenditures (for purposes of figuring the other credit).

**Note:** For credits entered on line 5, only the pass-through entity is required to make this reduction.

### Recapture of Credit

You may have to recapture part or all of the credit if, before the 10th tax year after the tax year in which your qualified childcare facility is placed in service, the facility ceases to operate as a qualified childcare facility or there is a change in ownership of the facility. However, a change in ownership will not require recapture if the person acquiring the interest in the facility agrees, in writing, to assume the recapture liability. See section 45F(d) for details.

Any recapture tax is reported on the line of your tax return where other recapture taxes are reported (or, if no such line, on the "total tax" line). The recapture tax may not be used in figuring the amount of any credit or in figuring the alternative minimum tax.

### Controlled Groups

All members of a controlled group of corporations (within the meaning of section 52(a)) and all partnerships, corporations, unincorporated businesses, and other persons under common control (within the meaning of section 52(b)) are treated as one person for purposes of the credit. The group member who would have the largest credit if this rule did not apply completes Form 8882, Part I, figures the group credit on line 7, and skips Part II. On separate Forms 8882, each member (including the member who completed the group Form 8882) skips lines 1 through 6 and enters its share of the group credit on line 7. Each member then completes Part II on its separate form (or Form 3800, if required). Each member also must attach a statement showing how the group credit was divided among all members. The members share the credit on line 2 in the same proportion that they contributed qualified childcare facility expenditures and share the credit on line 4 in the same proportion that they contributed qualified resource and referral expenditures.

### Additional Information

For more details, see section 45F.

## Specific Instructions

### Part I—Current Year Credit

Figure the credit for expenditures you paid on lines 1 through 4. Do not complete lines 1 through 4 for credits allocated to you from S corporations, partnerships, estates, or trusts; instead, complete line 5.

#### Line 1

Enter your qualified childcare facility expenditures (defined above) paid or incurred during the tax year.

#### Line 3

Enter your qualified childcare resource and referral expenditures (defined above) paid or incurred during the tax year.

#### Line 5

Enter the amount of credit that was allocated to you as a partner, shareholder, or beneficiary. Also enter the employer identification number (EIN) of the pass-through entity. If you received a credit from more than one pass-through entity, write "see attached" in the entry space for the EIN, and attach a statement showing the EIN and credit amount for each pass-through entity.

**Line 7**

**S corporations and partnerships.** Allocate the credit on line 7 among the shareholders and partners. Attach Form 8882 to the return and on Schedule K-1 show the credit for each shareholder or partner. Electing large partnerships must include this credit in "general credits."

**Estates and trusts.** The credit on line 7 is allocated between the estate or trust and the beneficiaries in proportion to the income allocable to each. On the dotted line next to line 7, the estate or trust should enter its part of the total credit. Label it "1041 Portion" and use this amount in Part II (or Form 3800, if required) to figure the credit to claim on Form 1041.

**Part II—Allowable Credit**

The credit allowed for the current year may be limited based on your tax liability. Use Part II to figure the allowable credit unless you must file **Form 3800**, General Business Credit.

**Who must file Form 3800.** You must file Form 3800 if you have:

- A credit for employer-provided childcare facilities and services from a passive activity,
- More than one of the credits included in the general business credit (other than a credit from Form 8844 or 8884), or
- A carryback or carryforward of any of those credits.

See the instructions for Form 3800 to find out which credits are included in the general business credit.

**Line 14**

See section 38(c)(4) for special rules that apply to married couples filing separate returns, controlled corporate groups, estates, and trusts.

**Line 15**

Although you may not owe the alternative minimum tax (AMT), you generally must still compute the tentative minimum tax (TMT) to figure your allowable credit. For a small corporation exempt from the AMT under section 55(e), enter zero. Otherwise, complete **and** attach the applicable AMT form or schedule and enter the TMT on line 15.

**Line 18**

If you cannot use all of your credit because of the tax liability limit (line 17 is smaller than line 7), carry the unused credit back 1 year then forward up to 20 years. See the instructions for Form 3800 for details.

**Paperwork Reduction Act Notice.** We ask for the information on this form to carry out the Internal Revenue laws of the United States. You are required to give us the information. We need it to ensure that you are complying with these laws and to allow us to figure and collect the right amount of tax.

You are not required to provide the information requested on a form that is subject to the Paperwork Reduction Act unless the form displays a valid OMB control number. Books or records relating to a form or its instructions must be retained as long as their contents may become material in the administration of any Internal Revenue law. Generally, tax returns and return information are confidential, as required by section 6103.

The time needed to complete and file this form will vary depending on individual circumstances. The estimated average time is:

- Recordkeeping** . . . . . 8 hr., 22 min.
- Learning about the law or the form** . . . . . 42 min.
- Preparing and sending the form to the IRS** . . . . . 52 min.

If you have comments concerning the accuracy of these time estimates or suggestions for making this form simpler, we would be happy to hear from you. See the instructions for the tax return with which this form is filed.



Name(s) shown on Form 1040

Your social security number

Before you begin: You need to understand the following terms. See Definitions on page 1 of the instructions.

- Dependent Care Benefits, Qualifying Person(s), Qualified Expenses, Earned Income

Part I Persons or Organizations Who Provided the Care—You must complete this part. (If you need more space, use the bottom of page 2.)

Table with 4 columns: (a) Care provider's name, (b) Address, (c) Identifying number (SSN or EIN), (d) Amount paid.

Did you receive dependent care benefits? No -> Complete only Part II below. Yes -> Complete Part III on the back next.

Caution. If the care was provided in your home, you may owe employment taxes. See the instructions for Form 1040, line 59.

Part II Credit for Child and Dependent Care Expenses

2 Information about your qualifying person(s). If you have more than two qualifying persons, see the instructions.

Table for line 2: (a) Qualifying person's name (First, Last), (b) Qualifying person's social security number, (c) Qualified expenses.

Main calculation table for lines 3-11, including a table for line 8: If line 7 is: Over, But not over, Decimal amount is.

**Part III Dependent Care Benefits**

<p><b>12</b> Enter the total amount of <b>dependent care benefits</b> you received for 2003. This amount should be shown in box 10 of your W-2 form(s). <b>Do not</b> include amounts that were reported to you as wages in box 1 of Form(s) W-2 . . . . .</p>	<b>12</b>			
<p><b>13</b> Enter the amount forfeited, if any (see the instructions) . . . . .</p>	<b>13</b>			
<p><b>14</b> Subtract line 13 from line 12 . . . . .</p>	<b>14</b>			
<p><b>15</b> Enter the total amount of <b>qualified expenses</b> incurred in 2003 for the care of the <b>qualifying person(s)</b> . . . . .</p>	<b>15</b>			
<p><b>16</b> Enter the <b>smaller</b> of line 14 or 15 . . . . .</p>	<b>16</b>			
<p><b>17</b> Enter your <b>earned income</b> . . . . .</p>	<b>17</b>			
<p><b>18</b> Enter the amount shown below that applies to you.</p> <ul style="list-style-type: none"> <li>• If married filing jointly, enter your spouse's earned income (if your spouse was a student or was disabled, see the instructions for line 5).</li> <li>• If married filing separately, see the instructions for the amount to enter.</li> <li>• All others, enter the amount from line 17.</li> </ul>	<b>18</b>			
<p><b>19</b> Enter the <b>smallest</b> of line 16, 17, or 18 . . . . .</p>	<b>19</b>			
<p><b>20 Excluded benefits.</b> Enter here the <b>smaller</b> of the following:</p> <ul style="list-style-type: none"> <li>• The amount from line 19 or</li> <li>• \$5,000 (\$2,500 if married filing separately <b>and</b> you were required to enter your spouse's earned income on line 18).</li> </ul>	<b>20</b>			
<p><b>21 Taxable benefits.</b> Subtract line 20 from line 14. Also, include this amount on Form 1040, line 7. On the dotted line next to line 7, enter "DCB" . . . . .</p>	<b>21</b>			

To claim the child and dependent care credit, complete lines 22–26 below.

<p><b>22</b> Enter \$3,000 (\$6,000 if two or more qualifying persons) . . . . .</p>	<b>22</b>			
<p><b>23</b> Enter the amount from line 20 . . . . .</p>	<b>23</b>			
<p><b>24</b> Subtract line 23 from line 22. If zero or less, <b>stop</b>. You cannot take the credit. <b>Exception.</b> If you paid 2002 expenses in 2003, see the instructions for line 9 . . . . .</p>	<b>24</b>			
<p><b>25</b> Complete line 2 on the front of this form. <b>Do not</b> include in column (c) any benefits shown on line 20 above. Then, add the amounts in column (c) and enter the total here . . . . .</p>	<b>25</b>			
<p><b>26</b> Enter the <b>smaller</b> of line 24 or 25. Also, enter this amount on line 3 on the front of this form and complete lines 4–11 . . . . .</p>	<b>26</b>			





# Instructions for Form 2441

## Child and Dependent Care Expenses

### Changes To Note

- The dollar limit on the amount of qualified expenses that can be used to figure the credit has been increased to \$3,000 for one qualifying person; \$6,000 for two or more qualifying persons.
- The maximum credit has been increased to \$1,050 for the care of one qualifying person; \$2,100 for the care of two or more qualifying persons.

### Purpose of Form

If you paid someone to care for your child or other qualifying person so you (and your spouse if filing a joint return) could work or look for work in 2003, you may be able to take the credit for child and dependent care expenses. But you must have had earned income to do so. If you can take the credit, use Form 2441 to figure the amount of your credit.

If you (or your spouse if filing a joint return) received **any dependent care benefits** for 2003, you **must** use Form 2441 to figure the amount, if any, of the benefits you may exclude from your income on Form 1040, line 7. You must complete Part III of Form 2441 before you can figure the credit, if any, in Part II.

### Definitions

#### Dependent Care Benefits

These include amounts your employer paid directly to either you or your care provider for the care of your qualifying person(s) while you worked. These benefits also include the fair market value of care in a day-care facility provided or sponsored by your employer. Your salary may have been reduced to pay for these benefits. If you received dependent care benefits, they should be shown in box 10 of your 2003 Form(s) W-2.

#### Qualifying Person(s)

A qualifying person is:

- Any child **under age 13** whom you can claim as a dependent (but see **Exception for Children of Divorced or Separated Parents** on this page). If the child turned 13 during the year, the child is a qualifying person for the part

of the year he or she was under age 13.

- Your disabled spouse who is not able to care for himself or herself.
- Any disabled person not able to care for himself or herself whom you can claim as a dependent (or could claim as a dependent except that the person had gross income of \$3,050 or more). But if this person is your child, see **Exception for Children of Divorced or Separated Parents** on this page.

To find out who is a dependent, see **Pub. 501**, Exemptions, Standard Deduction, and Filing Information.



*To be a qualifying person, the person **must** have shared the same home with you in 2003.*

#### Exception for Children of Divorced or Separated Parents

If you were divorced, legally separated, or lived apart from the other parent during the last 6 months of 2003, you may be able to take the credit or the exclusion even if your child is not your dependent. If your child is not your dependent, he or she is a qualifying person only if **all five** of the following apply.

1. You had custody of the child for a longer time in 2003 than the other parent. See **Pub. 501** for the definition of custody.
2. One or both of the parents provided over half of the child's support in 2003.
3. One or both of the parents had custody of the child for more than half of 2003.
4. The child was under age 13 or was disabled and could not care for himself or herself.
5. The other parent claims the child as a dependent because—
  - As the custodial parent, you signed **Form 8332** or a similar statement agreeing not to claim the child's exemption for 2003, or
  - Your divorce decree or written agreement went into effect before 1985 and it states that the other parent can claim the child as a dependent and the other parent gave at least \$600 for the child's support in 2003. But this rule does not apply if your decree or agreement was changed after 1984 to say that the other parent cannot claim the child as a dependent.

If this exception applies, the other parent cannot treat the child as a qualifying person even though the other parent claims the child as a dependent.

#### Qualified Expenses

These include amounts paid for household services and care of the qualifying person while you worked or looked for work. Child support payments are **not** qualified expenses. Also, expenses reimbursed by a state social service agency are **not** qualified expenses unless you included the reimbursement in your income.

#### Household Services

These are services needed to care for the qualifying person as well as to run the home. They include, for example, the services of a cook, maid, babysitter, housekeeper, or cleaning person if the services were partly for the care of the qualifying person. Do not include services of a chauffeur or gardener.

You can also include your share of the employment taxes paid on wages for qualifying child and dependent care services.

#### Care of the Qualifying Person

Care includes the cost of services for the qualifying person's well-being and protection. It does not include the cost of clothing or entertainment.

You can include the cost of care provided outside your home for your dependent under age 13 or any other qualifying person who regularly spends at least 8 hours a day in your home. If the care was provided by a dependent care center, the center must meet all applicable state and local regulations. A dependent care center is a place that provides care for more than six persons (other than persons who live there) and receives a fee, payment, or grant for providing services for any of those persons, even if the center is not run for profit.

You can include amounts paid for items other than the care of your child (such as food and schooling) **only** if the items are incidental to the care of the child and cannot be separated from the total cost. But **do not** include the cost of schooling for a child in the first grade or above. Also, **do not** include any expenses for sending your child to an overnight camp.

## Medical Expenses

Some disabled spouse and dependent care expenses may qualify as medical expenses if you itemize deductions on **Schedule A** (Form 1040). See **Pub. 503**, Child and Dependent Care Expenses, and **Pub. 502**, Medical and Dental Expenses, for details.

## Earned Income

Earned income includes the following amounts. If filing a joint return, figure your and your spouse's earned income separately.

- The amount shown on Form 1040, line 7, minus **(a)** any amount included for a scholarship or fellowship grant that was not reported to you on a Form W-2, **(b)** any amount also reported on **Schedule SE** (Form 1040) because you were a member of the clergy or you received \$108.28 or more of church employee income, and **(c)** any amount received as a pension or annuity from a nonqualified deferred compensation plan or a nongovernmental section 457 plan. This amount may be reported in box 11 of your Form W-2. If you received such an amount but box 11 is blank, contact your employer for the amount received as a pension or annuity. For purposes of Part III of Form 2441, earned income does not include any dependent care benefits shown on line 12 of Form 2441.
- The amount shown on Schedule SE, line 3, minus any deduction you claim on Form 1040, line 28. If you use either optional method to figure self-employment tax, subtract any deduction you claim on Form 1040, line 28, from the total of the amounts shown on Schedule SE, Section B, lines 3 and 4b. If you received church employee income of \$108.28 or more, subtract any deduction you claim on Form 1040, line 28, from the total of the amounts shown on Schedule SE, Section B, lines 3, 4b, and 5a.
- If you are filing **Schedule C** or **C-EZ** (Form 1040) as a statutory employee, the amount shown on line 1 of the schedule.

**Note:** You must reduce your earned income by any loss from self-employment.

## Special Situations

If you are filing a joint return, disregard community property laws. If your spouse died in 2003 and had no earned income, see Pub. 503. If your spouse was a student or disabled in 2003, see the instructions for line 5.

## Additional Information

For more details, see Pub. 503.

## Who Can Take the Credit or Exclude Dependent Care Benefits?

You can take the credit or the exclusion if **all six** of the following apply.

1. Your filing status is single, head of household, qualifying widow(er), or married filing jointly. But see **Married Persons Filing Separate Returns** on this page.
2. The care was provided so you (and your spouse if you were married) could work or look for work. However, if you did not find a job and have no earned income for the year, you cannot take the credit or the exclusion. But if your spouse was a student or disabled, see the instructions for line 5.
3. You (and your spouse if you were married) paid over half the cost of keeping up your home. The cost includes rent, mortgage interest, real estate taxes, utilities, home repairs, insurance on the home, and food eaten at home.
4. You and the qualifying person(s) lived in the same home.
5. The person who provided the care was not your spouse or a person whom you can claim as a dependent. If your child provided the care, he or she must have been age 19 or older by the end of 2003.
6. You report the required information about the care provider on line 1 and, if taking the credit, the information about the qualifying person on line 2.

## Married Persons Filing Separate Returns

If your filing status is married filing separately and **all** of the following apply, you are considered unmarried for purposes of figuring the credit and the exclusion on Form 2441.

- You lived apart from your spouse during the last 6 months of 2003, and
- The qualifying person lived in your home more than half of 2003, and
- You provided over half the cost of keeping up your home.

If you meet **all** the requirements to be treated as unmarried and meet items **2** through **6** listed earlier, you can take the credit or the exclusion. If you do not meet all the requirements to be treated as unmarried, you **cannot** take the credit. However, you can take the exclusion if you meet items **2** through **6**.

## Line Instructions

### Line 1

Complete columns **(a)** through **(d)** for each person or organization that provided the care. You can use **Form W-10**, Dependent Care Provider's Identification and Certification, or any other source listed in its instructions to get the information from the care provider. If you do not give correct or complete information, your credit (and exclusion, if applicable) may be disallowed unless you can show you used due diligence in trying to get the required information.

### Due Diligence

You can show a serious and earnest effort (due diligence) to get the information by keeping in your records a Form W-10 completed by the care provider. Or you may keep one of the other sources of information listed in the instructions for Form W-10. If the provider does not give you the information, complete the entries you can on line 1 of Form 2441. For example, enter the provider's name and address. Enter "See Page 2" in the columns for which you do not have the information. Then, on the bottom of page 2, explain that the provider did not give you the information you requested.

### Columns (a) and (b)

Enter the care provider's name and address. If you were covered by your employer's dependent care plan and your employer furnished the care (either at your workplace or by hiring a care provider), enter your employer's name in column **(a)**. Next, enter "See W-2" in column **(b)**. Then, leave columns **(c)** and **(d)** blank. But if your employer paid a third party (not hired by your employer) on your behalf to provide the care, you must give information on the third party in columns **(a)** through **(d)**.

### Column (c)

If the care provider is an individual, enter his or her social security number (SSN). Otherwise, enter the provider's employer identification number (EIN). If the provider is a tax-exempt organization, enter "Tax-Exempt" in column **(c)**.

### Column (d)

Enter the total amount you **actually paid** in 2003 to the care provider. Also, include amounts your employer paid to a third party on your behalf. It does not matter when the expenses were incurred. **Do not** reduce this amount by any reimbursement you received.

## Line 2

Complete columns (a) through (c) for each qualifying person. If you have **more than two** qualifying persons, attach a statement to your return with the required information. Be sure to put your name and social security number (SSN) on the statement. Also, enter "See Attached" on the dotted line next to line 3.

### Column (a)

Enter each qualifying person's name.

### Column (b)

You **must** enter the qualifying person's SSN. Be sure the name and SSN entered agree with the person's social security card. Otherwise, at the time we process your return, we may reduce or disallow your credit. If the person was born and died in 2003 and did not have an SSN, enter "Died" in column (b) and attach a copy of the person's birth certificate.

To find out how to get an SSN, see **Social Security Number (SSN)** on page 19 of the Form 1040 instructions. If the name or SSN on the person's social security card is not correct, call the Social Security Administration at 1-800-772-1213.

### Column (c)

Enter the qualified expenses you incurred and paid in 2003 for the person listed in column (a). Prepaid expenses are treated as paid in the year the care is provided. Do not include in column (c) qualified expenses:

- You incurred in 2003 but did not pay until 2004. You may be able to use these expenses to increase your 2004 credit.
- You incurred in 2002 but did not pay until 2003. Instead, see the instructions for line 9 on this page.
- You **prepaid** in 2003 for care to be provided in 2004. These expenses can only be used to figure your 2004 credit.

**TIP** *If you paid qualified expenses for the care of two or more qualifying persons, the \$6,000 limit does not need to be divided equally. For example, if you paid and incurred \$2,500 of qualified expenses for the care of one qualifying person and \$3,500 for the care of another qualifying person, you can use the total, \$6,000, to figure the credit.*

## Line 5

### Spouse Who Was a Student or Disabled

Your spouse was a **student** if he or she was enrolled as a full-time student at a school during any 5 months of 2003. A school does not include a night school

or correspondence school. Your spouse was **disabled** if he or she was not capable of self-care. Figure your spouse's earned income on a monthly basis.

For each month or part of a month your spouse was a student or was disabled, he or she is considered to have worked and earned income. His or her earned income for each month is considered to be at least \$250 (\$500 if more than one qualifying person was cared for in 2003). If your spouse also worked during that month, use the higher of \$250 (or \$500) or his or her actual earned income for that month. If, in the same month, both you and your spouse were either students or disabled, only one of you can be treated as having earned income in that month.

For any month that your spouse was not a student or disabled, use your spouse's actual earned income if he or she worked during the month.

## Line 9

### Credit for Prior Year's Expenses

If you had qualified expenses for 2002 that you did not pay until 2003, you may be able to increase the amount of credit you can take in 2003. To figure the credit, see the worksheet under **Amount of Credit** in Pub. 503. If you can take a credit for your 2002 expenses, enter the amount of the credit and "CPYE" on the dotted line next to line 9. Also, enter the name and social security number of the person for whom you paid the prior year's expenses to the right of this amount. Then, add the credit to the amount on line 9 and replace the amount on line 9 with that total. Also, attach a statement showing how you figured the credit.

## Line 13

If you had a flexible spending account, any amount included on line 12 that you did not receive because you did not incur the expense is considered forfeited. Enter the forfeited amount on line 13. **Do not** include amounts you expect to receive at a future date.

**Example.** Under your employer's dependent care plan, you chose to have your employer set aside \$5,000 to cover your 2003 dependent care expenses. The \$5,000 is shown in box 10 of your Form W-2. In 2003, you incurred and were reimbursed for \$4,950 of qualified expenses. You would enter \$5,000 on line 12 and \$50, the amount forfeited, on line 13.

## Line 15

Enter the total of all qualified expenses incurred in 2003 for the care of your

qualifying person(s). It does not matter when the expenses were paid.

**Example.** You received \$2,000 in cash under your employer's dependent care plan for 2003. The \$2,000 is shown in box 10 of your Form W-2. Only \$900 of qualified expenses were incurred in 2003 for the care of your 5-year-old dependent child. You would enter \$2,000 on line 12 and \$900 on line 15.

## Line 18

If your filing status is married filing separately, see **Married Persons Filing Separate Returns** on page 2. Are you considered unmarried under that rule?

- Yes.** Enter your earned income (from line 17) on line 18. On line 20, enter the **smaller** of the amount from line 19 or \$5,000.
- No.** Enter your spouse's earned income on line 18. If your spouse was a student or disabled in 2003, see the instructions for line 5. On line 20, enter the **smaller** of the amount from line 19 or \$2,500.

---

### Paperwork Reduction Act Notice.

We ask for the information on this form to carry out the Internal Revenue laws of the United States. You are required to give us the information. We need it to ensure that you are complying with these laws and to allow us to figure and collect the right amount of tax.

You are not required to provide the information requested on a form that is subject to the Paperwork Reduction Act unless the form displays a valid OMB control number. Books or records relating to a form or its instructions must be retained as long as their contents may become material in the administration of any Internal Revenue law. Generally, tax returns and return information are confidential, as required by Internal Revenue Code section 6103.

The time needed to complete and file this form will vary depending on individual circumstances. The estimated average time is:

**Recordkeeping**, 39 min.; **Learning about the law or the form**, 25 min.; **Preparing the form**, 50 min.; and **Copying, assembling, and sending the form to the IRS**, 27 min.

If you have comments concerning the accuracy of these time estimates or suggestions for making this form simpler, we would be happy to hear from you. See the Instructions for Form 1040.

---