



# Pennsylvania Child and Dependent Care Enhancement Tax Credit

## The Federal Child and Dependent Care Tax Credit

The federal government offers the Child and Dependent Care Tax Credit. (26 U.S.C. § 21) This federal tax credit is for individuals with one or more qualifying children or other dependents for expenses related to their care.

### Who Qualifies as a Dependent?

Under federal law, individuals that qualify as a dependent include:

- 1) A dependent child of the taxpayer that is under the age of 13;
- 2) The spouse of the taxpayer who is physically or mentally incapable of caring for themselves and who lives with the taxpayer for more than half of the tax year; or
- 3) An individual who is physically or mentally incapable of caring for themselves, who lives with the taxpayer for more than half of the tax year, and either:
  - Was the taxpayer's dependent; or
  - Could have been the taxpayer's dependent, but they received gross income of \$4,400 or more, filed a joint return, or could have been claimed as a dependent on another taxpayer's return.

### How is the Tax Credit Calculated?

The federal Child and Dependent Care Tax Credit is calculated based on three factors:

- 1) The taxpayer's income;
- 2) The number of children or other dependents the taxpayer has; and
- 3) The amount of employment-related expenses incurred to care for the qualifying dependents of the taxpayer.

Under the Internal Revenue Code, the credit is equal to "the applicable percentage of the employment-related expenses (as defined in subsection (b)(2)) paid by such individual during the taxable year." 26 U.S.C. § 21(a). The applicable percentage applied in the calculation of the tax credit amount is based on the taxpayer's adjusted gross income ("AGI") and ranges from 20 percent to 35 percent.



Federal Child and Dependent Care Tax Credit: Applicable Percentage	
Adjusted Gross Income	Applicable Percentage
\$15,000 or Less	35%
\$15,001-\$17,000	34%
\$17,001-\$19,000	33%
\$19,001-\$21,000	32%
\$21,001-\$23,000	31%
\$23,001-\$25,000	30%
\$25,001-\$27,000	29%
\$27,001-\$29,000	28%
\$29,001-\$31,000	27%
\$31,001-\$33,000	26%
\$33,001-\$35,000	25%
\$35,001-\$37,000	24%
\$37,001-\$39,000	23%
\$39,001-\$41,000	22%
\$41,001-\$43,000	21%
\$43,001 or More	20%

The other portion of the calculation is the employment-related expenses paid by a taxpayer throughout the year. The Internal Revenue Code defines employment-related expenses as amounts paid for household services and other care for the child or dependent individual that enable the taxpayer (i.e., the caretaker) to be gainfully employed or look for employment. For example, expenses paid to a daycare center, nursery school, pre-school, or similar program for children younger than kindergarten age would qualify as an employment-related expense so long as certain provisions are met. Alternatively, examples of expenses that would *not* qualify include, but are not limited to, overnight camp, clothing, educational expenses to attend kindergarten or a higher grade (i.e., private school), and entertainment.

The amount of employment-related expenses that a taxpayer is allowed to claim for each tax year is capped based on the number of children or dependents that the taxpayer cares for – taxpayers can annually claim up to \$3,000 of their expenses for one child or other dependent and up to \$6,000 of expenses for two or more children or other dependents.

The following is an example scenario for calculating the maximum federal tax credit amount for an individual with an annual income of \$15,000 who claims the full allowable amount of employment-related expenses for the tax year:

*One Child or Dependent: 35% x \$3,000 = \$1,050*

*Two or More Children or Dependents: 35% x \$6,000 = \$2,100*



The following is another example of calculating the maximum federal tax credit for an individual who earns \$50,000 and claims the full allowable employment-related expenses for the tax year:

$$\text{One Child or Dependent: } 20\% \times \$3,000 = \$600$$

$$\text{Two or More Children or Dependents: } 20\% \times \$6,000 = \$1,200$$

## Pennsylvania Child and Dependent Care Enhancement Tax Credit

### Establishment

Act 53 of 2022 amended the Tax Reform Code of 1971 to establish the Pennsylvania Child and Dependent Care Enhancement Tax Credit. This refundable state tax credit was built upon the federal Child and Dependent Care Tax Credit to provide an additional state tax benefit to Pennsylvania families to ease the burden of child and dependent care expenses. To claim the state tax credit, Pennsylvania taxpayers are required to first claim the federal Child and Dependent Care Tax Credit.

At its inception, the Pennsylvania Child and Dependent Care Enhancement Tax Credit was equal to 30 percent of the federal tax credit. In the example of a Pennsylvania taxpayer who earns \$15,000 and claims the full allowable employment-related expenses for the tax year, their state Child and Dependent Care Enhancement Tax Credit was calculated as follows:

#### **One Child or Dependent**

$$\text{Federal Credit Amount: } 35\% \times \$3,000 = \$1,050$$

$$\text{State Credit Amount: } 30\% \times \$1,050 = \$315$$

#### **Two or More Children or Dependents**

$$\text{Federal Credit Amount: } 35\% \times \$6,000 = \$2,100$$

$$\text{State Credit Amount: } 30\% \times \$2,100 = \$630$$

Similarly, the state tax credit amount for the Pennsylvania taxpayer who earns \$50,000 and claims the full allowable employment-related expenses was calculated as follows:

#### **One Child or Dependent**

$$\text{Federal Credit Amount: } 20\% \times \$3,000 = \$600$$

$$\text{State Credit Amount: } 30\% \times \$600 = \$180$$

#### **Two or More Children or Dependents**

$$\text{Federal Credit Amount: } 20\% \times \$6,000 = \$1,200$$

$$\text{State Credit Amount: } 30\% \times \$1,200 = \$360$$

Pennsylvania families could begin claiming the Pennsylvania Child and Dependent Care Enhancement Tax Credit on their 2022 taxes, which they would have filed by April of 2023, under these aforementioned parameters. According to the Department of Revenue, over 173,000 taxpayers claimed this state tax credit as of April 18, 2023, reflecting an estimated \$32.8 million in approved credits and \$2.1 million in refunded credits.



## Expansion of the Pennsylvania Child and Dependent Care Enhancement Tax Credit

The Fiscal Code bill enacted as a part of the 2023/24 budget package (Act 34 of 2023) expanded the Pennsylvania Child and Dependent Care Enhancement Tax Credit from 30 percent of a taxpayer's federal tax credit amount to 100 percent of their federal credit. In other words, the amount that Pennsylvanians receive under the Pennsylvania Child and Dependent Care Enhancement Tax Credit will match what they receive from the federal Child and Dependent Care Tax Credit during the same tax year, as opposed to receiving only a portion of what they received.

This expansion is effective for tax year 2023, meaning that Pennsylvania taxpayers will first see an increase in their Pennsylvania Child and Dependent Care Enhancement Tax Credit amount when they file their taxes in April 2024. The following table illustrates how this expansion will impact maximum state tax credit amounts for individuals based on their income.

Pennsylvania Child and Dependent Care Enhancement Tax Credit: Tax Credit Amounts Before and After Expansion					
Adjusted Gross Income	Federal Applicable Percentage	State Tax Credit Amounts Pre-Act 34 Expansion		State Tax Credit Amounts with Act 34 Expansion	
		One Dependent	Two or More Dependents	One Dependent	Two or More Dependents
\$15,000 or Less	35%	\$315	\$630	\$1,050	\$2,100
\$15,001-\$17,000	34%	\$306	\$612	\$1,020	\$2,040
\$17,001-\$19,000	33%	\$297	\$594	\$990	\$1,980
\$19,001-\$21,000	32%	\$288	\$576	\$960	\$1,920
\$21,001-\$23,000	31%	\$279	\$558	\$930	\$1,860
\$23,001-\$25,000	30%	\$270	\$540	\$900	\$1,800
\$25,001-\$27,000	29%	\$261	\$522	\$870	\$1,740
\$27,001-\$29,000	28%	\$252	\$504	\$840	\$1,680
\$29,001-\$31,000	27%	\$243	\$486	\$810	\$1,620
\$31,001-\$33,000	26%	\$234	\$468	\$780	\$1,560
\$33,001-\$35,000	25%	\$225	\$450	\$750	\$1,500
\$35,001-\$37,000	24%	\$216	\$432	\$720	\$1,440
\$37,001-\$39,000	23%	\$207	\$414	\$690	\$1,380
\$39,001-\$41,000	22%	\$198	\$396	\$660	\$1,320
\$41,001-\$43,000	21%	\$189	\$378	\$630	\$1,260
\$43,001 or More	20%	\$180	\$360	\$600	\$1,200

Note: Tax credit amounts assume taxpayers claim the maximum allowable employment-related expenses for the tax credit, which are currently capped at \$3,000 for one dependent and \$6,000 for two or more dependents.

