

Section 45F & the Dependent Care FSA *under H.R. 1*

A reference guide to the federal employer tax rules that make the Iron Range Slot Compact viable for businesses across the Taconite Assistance Area.

Companion to *Child Care as Workforce Infrastructure*, the April 2026 policy brief prepared by Rural Pathways for the Iron Range Child Care Task Force.

Prepared by

Rural Pathways
for the Iron Range Child Care
Task Force

Audience

Employers, finance teams,
chambers, and economic
development authorities

Effective

Tax years beginning after
December 31, 2025

INTRODUCTION

A practical reference for the employer side of the *Slot Compact*.

The April 2026 policy brief *Child Care as Workforce Infrastructure* proposes a regional Employer Slot Compact: a pooled fund, contributed to by participating employers, that stabilizes provider operations across the Taconite Assistance Area. The federal mechanism that makes that pool affordable for individual employers is Section 45F of the Internal Revenue Code, significantly expanded under the One Big Beautiful Bill Act for tax years beginning after December 31, 2025.

This guide is a companion reference for finance teams and decision-makers evaluating participation. It explains the rules, walks through the math, and addresses the practical questions that arise when a business considers contributing to the Compact for the first time. It is organized into five sections: how Section 45F works under the new law, how the credit interacts with taxable income and the Tentative Minimum Tax, how the Dependent Care FSA stacks alongside it, where Iron Range business types fall in the analysis, and a glossary of terms.

It is not legal or tax advice. Every business situation differs, and the figures shown here are illustrative. Decisions about claiming Section 45F or adopting the higher DCFSFA limit should be made in consultation with a qualified CPA or tax attorney familiar with the business's specific circumstances.

SECTION 1 · HOW SECTION 45F WORKS

The federal employer-provided child care credit, *under H.R. 1*.

What is Section 45F?

Section 45F is a federal tax credit available to for-profit employers that fund or contribute to child care benefits for their employees. It has existed since 2001, but the One Big Beautiful Bill Act (H.R. 1, signed into law on July 4, 2025) significantly enhanced its rates, caps, and eligible structures for tax years beginning after December 31, 2025.

The credit is part of the General Business Credit (GBC), which means it shares the GBC's mechanics, including the Tentative Minimum Tax limitation discussed in Section 2. Nonprofits, including hospital systems organized as 501(c)(3) entities, do not pay federal income tax and therefore cannot use the credit.

What changed under the 2025 expansion?

Three changes matter most for rural employers considering participation in a regional pooled fund:

The credit rate roughly doubled. The previous flat 25% rate became 40% for all qualifying businesses and 50% for small businesses. Most Iron Range employers fall within the small business definition.

The annual cap quadrupled. The previous \$150,000 cap rose to \$500,000 for businesses in the standard tier and \$600,000 for small businesses, with both caps indexed to inflation going forward.

Intermediary contracts now qualify. The law explicitly recognizes contracts in which multiple employers jointly contract with a qualified child care provider through an intermediary organization. This is the structural change that makes a regional pooled compact workable. Under the prior rules, an employer-by-employer arrangement was effectively the only path; small and rural employers, lacking the scale to support a center on their own, were largely shut out.

TIER	CREDIT RATE	ANNUAL CAP	ELIGIBILITY
Small Business	50%	\$600,000	Average annual gross receipts under approximately \$31M (2026)
All Businesses	40%	\$500,000	Any for-profit employer regardless of size

How is the small business threshold defined?

A business qualifies for the small business tier if its average annual gross receipts fall below approximately \$31 million as of 2026. This figure is the long-standing gross receipts test from the federal tax code, indexed to inflation. The threshold is applied to the business's average across the prior three tax years rather than a single year, which smooths year-to-year fluctuations.

Most Iron Range businesses, including the majority of restaurants, lodging operators, mining suppliers, breweries, and small contractors, fall comfortably below this threshold. Larger employers, including the taconite operators themselves and their largest direct vendors, fall into the standard 40% tier.

What expenses qualify for the credit?

Three categories of expenditure qualify:

Construction or acquisition of a child care facility used to provide care to employees, including the costs of expanding or renovating an existing facility.

Operating expenses at a qualified child care facility, including staff wages, training, scholarships, and other ongoing costs that support employee child care access.

Resource and referral expenditures, including the costs of helping employees locate care.

For employers participating in a regional pooled compact, contributions are paid to the intermediary organization and applied to qualifying provider operating expenses across the participating provider network. The intermediary's contract documentation establishes the qualifying nature of the expenditure for each contributing employer.

SECTION 2 · TAXABLE INCOME & THE TMT LIMITATION

Why the credit's *practical value* depends on a business's tax profile.

Calculating the gross 45F credit is straightforward: it is the credit rate times the qualifying expenditure, up to the annual cap. Determining how much of that credit a business can actually use in a given year is more involved, and the answer depends on a federal limitation called the Tentative Minimum Tax.

What is the Tentative Minimum Tax, and why does it matter?

The Tentative Minimum Tax (TMT) is the federal floor below which the General Business Credit, and therefore Section 45F, cannot reduce a business's tax liability. The General Business Credit can only offset the portion of regular tax that exceeds the TMT.

In practice, the TMT typically equals approximately 85% of regular tax liability. The mathematical consequence is that only the top ~15% of a tax bill is available in any single year to absorb the 45F credit. Unused credit does not disappear; it carries forward to future years and can offset future tax liability subject to the same TMT constraint each year.

How does the calculation work in practice?

The math has four steps:

1. Calculate regular tax from taxable income using standard federal corporate brackets.
2. Calculate TMT, which approximates 85% of regular tax.
3. The TMT gap is regular tax minus TMT, which represents the maximum credit usable in the current year.
4. The 45F credit claimed in the current year is the lesser of the calculated credit amount or the TMT gap. Any remainder carries forward.

WORKED EXAMPLE · MID-SIZED IRON RANGE EMPLOYER

Taxable income	\$1,400,000
Regular tax (21% federal corporate rate)	\$294,000
Tentative Minimum Tax (~85% of regular tax)	\$249,900
TMT gap available for credits this year	\$44,100
Slot Compact contribution	\$50,000
Calculated 45F credit (50% small business rate)	\$25,000
Credit usable this year (lesser of credit or TMT gap)	\$25,000
Credit carried forward to future years	\$0

When does the TMT limit become a real constraint?

The TMT gap becomes binding when the calculated 45F credit exceeds the gap. For most Iron Range businesses making moderate Compact contributions, the credit fits within the gap and is fully usable in year one. The constraint matters most for businesses making large contributions, businesses in low-income years (a slow season for lodging, a depressed price year for timber, a project gap for construction), or businesses with significant other General Business Credits already in use.

Businesses with very large taxable incomes have correspondingly large TMT gaps and rarely encounter the limit. Businesses with thin margins or seasonal income volatility may see a portion of their 45F credit roll forward. The credit is not lost; it is simply applied across multiple years.

Can the contribution also be deducted as a business expense?

Yes, and the two benefits stack. Employer child care contributions are deductible as ordinary compensation expense under IRC Section 162, similar to wages or health insurance. The 45F credit applies on top of that deduction, subject to one guardrail: under IRC Section 280C, a business must reduce its Section 162 deduction by the amount of 45F credit claimed in the same year. The two benefits cannot be applied to the same dollar, but they can be applied to different portions of the same contribution.

Worked example. A small business contributing \$100,000 to the Slot Compact in a year where the full credit is usable claims a \$50,000 credit at the 50% rate, reducing tax owed dollar-for-dollar. The remaining \$50,000 (the contribution net of credit claimed) is deductible under Section 162. At a 21% C-corp rate, that deduction yields another \$10,500 in tax savings; at a pass-through marginal rate of 32%, it yields closer to \$16,000. The combined federal benefit is roughly \$60,500 to \$66,000 on the \$100,000 contribution, depending on entity type.

One nuance worth flagging for your CPA. Section 280C reduces the deduction only by the credit *claimed* in the current year, not by the credit *generated*. In a TMT-constrained year where part of the credit rolls forward, the current-year deduction stays large, and the deduction reduction follows the credit into future years as the carryforward is used.

SECTION 3 · THE DEPENDENT CARE FSA

A complementary, near-term win for *both employer and employee.*

A Dependent Care Flexible Spending Account (DCFSA) is an employer-offered, pre-tax employee benefit account for child care expenses. It is distinct from Section 45F: where 45F is a tax credit on employer contributions to child care, the DCFSA is a tax-advantaged vehicle for employee out-of-pocket spending. The two work together cleanly and address different parts of a family's child care cost.

A NOTE ON TERMINOLOGY

DCFSA, DCAP, and the direct-subsidy alternative

A **DCFSA** is one specific implementation of a broader IRS category called a **Dependent Care Assistance Program (DCAP)**, defined in IRC § 129. The DCAP umbrella covers any employer-provided child care benefit that is excluded from employee gross income up to the annual limit. The DCFSA — a salary-reduction account funded through a cafeteria plan — is the most common form, but it is not the only one.

Other DCAP forms

A direct employer subsidy of an employee's child care costs, employer contributions to an employee's dependent care account, on-site care provided as a benefit, and dependent care vouchers all qualify as DCAPs. Each one delivers tax-free child care benefits to employees up to the same § 129 ceiling that governs the DCFSA.

What changed under H.R. 1

The H.R. 1 increase to \$7,500 raised the underlying § 129 DCAP exclusion limit, which flows through to all DCAP forms — not just the DCFSA. Any combination of DCAP benefits an employee receives counts against the same \$7,500 household ceiling.

The direct-subsidy alternative

For some Iron Range employers, a direct subsidy of an employee's child care costs may be more meaningful than a salary-reduction account. The employer pays a portion of the employee's tuition or co-pay directly, and that amount is excluded from the employee's W-2 wages up to \$7,500 per household. Unlike the DCFSA, this approach requires real employer dollars rather than employee pre-tax payroll deductions — but it can be paired with the Slot Compact to reach lower-wage workers who may not have payroll headroom to fund a DCFSA.

How this interacts with the Slot Compact

The Slot Compact contribution is **not** a DCAP. It is paid by the employer to the regional intermediary fund for provider operations — a § 45F qualifying expenditure under a different code section entirely. The two operate independently and the \$7,500 DCAP ceiling does not apply to Compact contributions. Employers can use both, in any combination, without the limits interacting.

W-2 reporting

Any DCAP benefit — DCFSA, direct subsidy, or other form — is reported in **Box 10** of the employee's W-2. Amounts above \$7,500 are taxable to the employee. The Slot Compact contribution is not reported on individual W-2s because it is not a benefit to a specific employee.

How does a DCFSA work?

An employee elects an annual contribution amount during open enrollment. Funds are deducted from each paycheck before federal income tax, state income tax (in most states), and FICA payroll taxes are calculated. The employee submits receipts for eligible child care expenses, including licensed daycare, preschool, before- and after-school care for children under 13, and similar services, and is reimbursed from the account.

The employee saves at their marginal tax rate plus the 7.65% employee FICA share. The employer saves the 7.65% employer FICA match on every dollar an employee contributes. Both savings are immediate and not subject to the TMT limitation that affects Section 45F.

What changed under H.R. 1 in 2026?

The DCFSA per-household contribution limit rose from \$5,000 to \$7,500, effective January 1, 2026. This is the first increase in the limit since 1986. The limit for married couples filing separately is \$3,750. The higher limit is optional for employers: a plan must be amended to adopt it, and employers may continue offering only the \$5,000 limit if they choose.

For employees with high child care costs (typical for an infant or toddler in licensed care), the new limit allows substantially more of their family child care budget to flow through pre-tax dollars. For employers, the higher limit also expands employer FICA savings on the additional pre-tax wages.

How do the DCFSA and the Slot Compact contribution interact?

They apply to entirely separate dollars and stack cleanly. The DCFSA covers the employee's own out-of-pocket child care payments, up to \$7,500 per household. The Slot Compact contribution is paid by the employer to the regional intermediary fund and supports provider operations across the participating network. Because the two are paid by different parties for different purposes, the IRS does not treat them as overlapping, and the anti-double-dipping rule in Section 280C does not apply between them.

The practical implication for a business is that adopting a DCFSA and contributing to the Slot Compact are not alternatives. They are layered benefits, each addressing a different part of the child care cost equation.

What about nondiscrimination testing under the higher limit?

The IRS requires DCFSA to satisfy the Average Benefits Test: the average DCFSA benefit received by non-highly compensated employees must equal at least 55% of the average benefit received by highly compensated employees. With the limit at \$5,000, this rarely created problems. With the limit at \$7,500, plans where senior staff max out their contributions while lower-wage staff contribute little or nothing can fail the test, in which case highly compensated employees lose the tax-free treatment of their contributions for that year.

This is not a reason to avoid the higher limit. It is a reason to consider expected participation patterns before adopting it, and to communicate the benefit clearly across the workforce so participation is broader than just the top of the org chart.

When is the DCFSA the better starting point?

For many small Iron Range employers, the DCFSA is the most reliable near-term win. It carries no significant cash outlay (only plan administration costs), the employer FICA savings are immediate, it is not constrained by the TMT, and it provides a meaningful benefit to the workforce regardless of the employer's tax profile in any given year.

The DCFSA and the Slot Compact contribution are most powerful when used together. The DCFSA addresses employee tax efficiency on the payments families make themselves; the Slot Compact

addresses the provider stabilization that makes those payments matter. A complete employer strategy includes both.

RECOMMENDED IMPLEMENTATION SEQUENCE

1. Adopt or amend a DCFSA plan to the new \$7,500 limit. The administrative path is well-established and benefit kicks in on the next pay cycle.
2. Communicate the benefit broadly across the workforce, and review expected participation patterns to confirm the plan will satisfy the Average Benefits Test.
3. Evaluate participation in the Slot Compact through the intermediary contract structure, with a contribution sized to the business’s expected TMT gap and broader workforce strategy.
4. File Form 8882 with the business’s federal return to claim the 45F credit on the Slot Compact contribution. Maintain documentation of the intermediary contract and contribution amount.

SECTION 4 · HOW THE MATH PLAYS OUT FOR IRON RANGE BUSINESSES

The TMT gap looks *different across business types*.

Section 45F is structured the same way for every employer, but the practical year-one usability of the credit varies meaningfully across business types. The table below describes typical patterns for Iron Range employer categories. Actual outcomes depend on the specific business’s revenue, taxable income, and existing General Business Credits, and should be modeled in consultation with the business’s tax advisor.

BUSINESS TYPE	TYPICAL GROSS RECEIPTS	TMT GAP REALITY
Auto shop or small contractor	~\$800K	Very narrow gap; a modest Compact contribution mostly rolls forward, but the §162 deduction and DCFSA FICA savings are immediate. DCFSA is the priority lever at this scale.
Restaurant	~\$4M	Narrow gap; smaller contributions fit in year one, larger contributions roll forward.
Mining supplier	~\$28M	Moderate gap; most reasonable Compact contributions usable in year one.
Lodging or resort	~\$8M	Seasonal income compresses the gap in slow years; carryforward common.
Timber or logging	~\$18M	Equipment depreciation compresses taxable income and the gap.
Heavy construction	~\$35M	Variable by project year; standard 40% tier applies above the threshold.

Craft brewery	~\$5M	Narrow gap; DCFSA may be the stronger near-term lever.
Taconite operator	\$200M+	Wide gap; full credit typically usable immediately.

A NOTE ON MINNESOTA STATE TAX

How Minnesota tax interacts with the federal stack

Minnesota corporate franchise tax (9.8%) and individual income tax (top rate 9.85%) both start with federal taxable income. That has a quiet but meaningful consequence for Slot Compact participation: the federal Section 162 deduction on the contribution — net of the §45F credit reduction under §280C — flows through to Minnesota taxable income automatically, with no additional filing or election required.

What this means in dollars

A C-corp claiming a \$50,000 §45F credit on a \$100,000 contribution has a \$50,000 federal §162 deduction (the contribution net of credit). At a 21% federal rate, that deduction is worth \$10,500. At a 9.8% Minnesota rate, the same \$50,000 deduction is worth another \$4,900 — a benefit Minnesota taxpayers receive simply because Minnesota conforms to the federal definition of taxable income. For pass-through owners at the top Minnesota individual rate, the figure is closer to \$4,925.

On pending state legislation

Minnesota has pending legislation that, if enacted, would create a state-level employer child care credit on top of the federal §45F structure. The bills are pending and the specific terms could change materially before passage; this guide does not attempt to model them. Employers evaluating Slot Compact participation should ask their CPA whether any state-level credit has been enacted in the relevant tax year. The interactive calculator at 45f-calculator.netlify.app includes scenario toggles for the current versions of the pending bills, updated as the legislative process advances.

A NOTE ON NONPROFITS

Hospital systems, colleges, and other tax-exempt organizations that anchor regional employment in the TAA do not pay federal income tax and therefore cannot use Section 45F. These employers have other meaningful roles in the regional child care strategy, including direct provider partnerships, employee benefit design, and convening and advocacy. The Slot Compact's tax credit mechanism is one of several pathways for employer engagement; nonprofit employers are not the audience for this particular tool.

How do these patterns inform the participation decision?

The variance across business types is a reason to model the math, not a reason to defer participation. A Compact contribution that produces a partial year-one credit and a partial carryforward still represents real value; it simply realizes that value across multiple years rather than all at once. The DCFSA, by contrast, is fully usable in year one regardless of business tax profile and serves as a durable foundation that strengthens the case for layering the Compact contribution on top.

The interactive calculator at 45f-calculator.netlify.app models these scenarios in real time using pre-loaded business profiles or custom inputs. The calculator now includes a Section 162 deduction layer

alongside the 45F credit calculation, showing the TMT gap, year-one usable credit, any carryforward, the net-of-credit deduction value at C-corp or pass-through marginal rates, and the combined federal employer benefit. It is designed to support, not replace, conversations with a qualified tax advisor.

SECTION 5 · GLOSSARY

Key terms used *throughout this guide.*

Section 45F	The federal employer-provided child care credit, codified at IRC § 45F. Significantly enhanced under H.R. 1 (One Big Beautiful Bill Act) for tax years beginning after December 31, 2025. Part of the General Business Credit.
General Business Credit (GBC)	The umbrella federal tax credit category that includes Section 45F and many other business credits. The GBC is subject to the Tentative Minimum Tax limitation, which determines how much of the credit a business can use in any single year.
Tentative Minimum Tax (TMT)	The federal floor below which the General Business Credit cannot reduce tax liability. Approximately 85% of regular tax. The TMT is the central reason why a business's practical credit usability depends on its income profile.
TMT Gap	Regular tax minus TMT. The maximum General Business Credit (and therefore Section 45F) usable in a given year. Unused credit carries forward to future tax years.
Qualified expenditure	A child care expense that counts toward the 45F credit. Includes facility construction or operation, employee child care subsidies, and resource and referral costs paid through a qualified arrangement.
Intermediary contract	A contract through which multiple employers jointly arrange for employee child care services through a single intermediary organization. Explicitly recognized as a qualifying 45F arrangement under H.R. 1. The legal structure that enables a regional pooled compact.
Small business tier	The 50% credit rate and \$600,000 annual cap available to businesses with average annual gross receipts below approximately \$31 million (2026, indexed). Most Iron Range employers qualify.
IRC § 162	The federal tax provision under which employer child care contributions are deductible as ordinary business expenses, similar to wages. The §162 deduction applies on top of the 45F credit, subject to the §280C reduction.
DCAP	Dependent Care Assistance Program. The IRS umbrella category (IRC § 129) for any employer-provided child care benefit excluded from employee gross income up to \$7,500 per household. Includes DCFSA, direct subsidies, employer contributions to dependent care accounts, on-site care, and dependent care vouchers. All DCAP forms share the same household ceiling.

DCFSA	Dependent Care Flexible Spending Account. The salary-reduction (cafeteria plan) form of a DCAP. The most common implementation, funded through pre-tax payroll deductions. Same \$7,500 household limit as other DCAPs.
FICA	Federal payroll taxes (Social Security plus Medicare). Employer pays a 7.65% match on employee wages. DCFSA contributions reduce the wage base, generating immediate FICA savings for both parties.
IRC § 280C	The anti-double-dipping rule. Reduces the §162 business expense deduction by the amount of 45F credit claimed in the same year, preventing both benefits from applying to the same dollar.
Form 8882	The IRS form used to claim the Section 45F credit. Filed with the employer's federal tax return alongside Form 3800 (General Business Credit).
H.R. 1 / OBBBA	One Big Beautiful Bill Act (Public Law 119-21), signed July 4, 2025. Contains both the enhanced Section 45F provisions (Sec. 70401) and the DCFSA limit increase to \$7,500.

***For illustrative purposes only.** This guide summarizes federal tax rules in plain language and is not a substitute for professional tax advice. Every business situation differs. Decisions about claiming Section 45F, adopting an enhanced DCFSA limit, or participating in the Iron Range Slot Compact should be made in consultation with a qualified CPA or tax attorney familiar with the business's specific circumstances.*