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Pennsylvania Aligns Dependent Care Benefits with Federal Tax Rules

The Commonwealth of Pennsylvania recently enacted Act 34, Section 202.3 (HB 1300) (“The Act”), which, among other things, amended Pennsylvania law to allow for employer-provided dependent care assistance, including a Section 125 Dependent Care Assistance Program (“DCAP”), to be excluded from an employees’ income for state income tax purposes. The Act is effective retroactively back to January 1, 2023.

■ Exclusion from Income Taxation

The Act aligns Pennsylvania’s tax code with Section 129 of the Internal Revenue Code by allowing employees to exclude dependent care assistance provided by their employers from their personal income tax. For purposes of this exclusion, “dependent care assistance” is considered:

- the fair market value of daycare facility benefits provided by an employer;
- an amount paid directly by the employer to a daycare facility or reimbursed to the employee to subsidize the benefit; and
- benefits from the pre-tax contributions made by the employee under a Section 125 DCAP flexible spending account.

■ Correcting Inaccurate Form W-2s

Because the Act is effective retroactively, it is likely that employers withheld tax for employer-provided dependent care assistance for the 2023 tax year. This could create issues for employees when they file their 2023 state income tax return. In published guidance, the Pennsylvania Department of Revenue (“DOR”) has provided steps to address this issue:

- If an employer has already filed their W-2s with the DOR, they should file corrected W-2s with the dependent care assistance excluded. Employees can exclude up to the federal maximum annual limit (\$5,000 for 2024). The employee(s) should also be provided with a corrected W-2.



- If an employer has not yet filed their W-2s with the DOR, they can file updated W-2s in which the dependent care benefits reported in Box 10 are not included in Box 16 (State Wages). The updated W-2 should also be provided to the applicable employee(s).
- Employers should not file amended W-3s and Annual Withholding Reconciliation Statements (REV-1667s) to remove withholding for dependent care assistance. Only W-2s should be amended.

■ Employer Action

Employers should file amended W-2s for any applicable employees according to the DOR's guidance. In addition, withholding for dependent care assistance benefits should be stopped as soon as possible. Payroll systems should be adjusted to ensure that dependent care assistance benefits are excluded from employees' taxable wages and are not included in their 2024 Form W-2.

Finally, any employee communications or plan documents which reference the prior taxation of dependent care assistance benefits in Pennsylvania should be updated to remove this language.