

# ANALYSIS OF AMENDED BILL

Franchise Tax Board

Author: Anderson Analyst: Angela Raygoza Bill Number: AB 1990

Related Bills: See Legislative History Telephone: 845-7814 Introduced Date: April 5, 2010

Attorney: Patrick Kusiak Sponsor: \_\_\_\_\_

**SUBJECT:** Unemployed Worker's Child Care Costs Contributions Credit

## SUMMARY

This bill would provide a tax credit for costs paid or incurred for child care, as specified.

## SUMMARY OF AMENDMENTS

The April 5, 2010, amendments would do the following:

- Remove intent language that would reduce personal income taxes, and
- Add language that would provide a tax credit for child care costs, as specified.

This is the department's first analysis of this bill.

## PURPOSE OF THE BILL

It appears the purpose of this bill is to assist unemployed taxpayers with child care costs during an economic downturn.

## EFFECTIVE/OPERATIVE DATE

As a tax levy, this bill would be effective immediately upon enactment and specifically operative for taxable years beginning on or after January 1, 2011.

## POSITION

Pending.

## ANALYSIS

### Current Federal Law

Existing federal law allows a non-refundable tax credit known as the federal Child Dependent Care (CDC) credit. In order to take this credit, a taxpayer must have employment-related child and dependent care expenses for the care of a qualifying individual and qualifying earned income. The basis of the credit is the lesser of the dependent care expenses or the least amount of earned income as determined for each taxpayer filing a joint return, but not more than \$3,000 per qualifying individual or \$6,000 for two or more qualifying individuals.

Board Position:

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\_\_\_\_\_ SA      \_\_\_\_\_ O      \_\_\_\_\_ NAR  
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Department Director

Date

Selvi Stanislaus

04/28/10

A qualifying individual for purposes of this credit is any dependent of the taxpayer who is under the age of 13 or a taxpayer's dependent or spouse who is physically or mentally unable to care for him or herself. Employment-related child and dependent care expenses are generally defined as those expenses incurred to enable gainful employment, e.g., housekeeping, babysitting, and other household services. Earned income is generally wages or other payments for services provided by the taxpayer.

Taxpayers must pay over half the cost of keeping up their primary home for the qualifying individuals. Costs include rent, mortgage interest, real estate taxes, utilities, home repairs, and food eaten at home.

The maximum amount of eligible employment-related expenses is \$3,000 for one qualifying individual and \$6,000 for two or more qualifying individuals. The maximum credit amount will be 35 percent of the credit basis. Thus, the maximum credit is \$1,050 if there is one qualifying individual and \$2,100 if there are two or more qualifying individuals.

The amount of the credit itself is based on a sliding scale percentage. If adjusted gross income (AGI) is \$15,000 or less, the taxpayer's credit is 35 percent of their employment related expenses. This percentage is phased down by 1 percent for each \$2,000 of AGI, or fraction thereof, in excess of \$15,000, but not to a percentage below 20 percent.

### **Current State Law**

Existing state law allows a credit similar to the federal CDC. Unlike the federal CDC, the California CDC is refundable.

The credit is limited to employment-related expenses as defined in federal law, but only for services provided in California and only to the extent of earned income from California sources. For taxable years beginning on or after January 1, 2003, the credit is 50 percent of the federal CDC for those with an AGI of \$40,000 or less; 43 percent for those with an AGI between \$40,001-\$70,000; 34 percent for those with an AGI between \$70,001-\$100,000; and no credit for those with an AGI over \$100,000.

### **THIS BILL**

Beginning on or after January 1, 2011, this bill would provide a tax credit for 100 percent of the costs paid or incurred by a taxpayer for contributions to child care costs made on behalf of any qualified dependent. The amount of the credit is limited to \$500 for each qualified dependent.

This bill would define the following:

- "Contributions" include direct payments to child care programs or providers.
- "Qualified child care" includes, but is not limited to, center-based service, in-home care, or home-provider care.
- "Qualified dependent" means any dependent of a taxpayer who is under 12 years of age.
- "Taxpayer" means any individual who is unemployed and who received unemployment insurance compensation benefits awarded pursuant to the Unemployment Insurance Code.<sup>1</sup>

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<sup>1</sup> Unemployment Insurance Benefits is defined in Chapter 5 (commencing with Section 1251) of Part 1 of Division 1 of the Unemployment Insurance Code.

This bill would allow the credit to be carried over to future years until exhausted.

This bill would disallow a deduction for the expenses paid or incurred that are equal to the amount of the credit.

### IMPLEMENTATION CONSIDERATIONS

The department has identified the following implementation concerns. Department staff is available to work with the author's office to resolve these and other concerns that may be identified.

This bill uses terms that are undefined, eg. "child care costs," "center-based service," "child care programs," and "providers." The absence of definitions to clarify these terms could lead to disputes with taxpayers and would complicate the administration of this credit.

It is unclear in this bill if the definition of "taxpayer" is limited to individuals who are unemployed and currently receiving unemployment insurance benefits or have ran out of these benefits. It is suggested that the bill be amended to clarify the definition of taxpayer by adding a requirement that the taxpayer be unemployed and have received unemployment compensation during the taxable year.

The bill uses the term "contributions" to include direct payments to child care programs or providers. It is unclear if the term "contributions" includes costs paid or incurred for child care costs. It is recommended the author amend the bill and use another term, such as "child care costs." Additionally, using the term "include" in the definition of "contributions" makes this limitation misleading. To clarify the definition, it is recommended author use "costs paid or incurred for qualified child care."

### **LEGISLATIVE HISTORY**

AB 847 (LaSuer, 2001/2002) would have increased the state adjusted gross income amounts, removed the language that allowed the CDC to be refundable, and allowed the credit to be carried over indefinitely. AB 847 failed to pass out of the first house by the constitutional deadline.

AB 480 (Ducheny, Ch.114, Stats. 2000) enacted the California CDC.

### **OTHER STATES' INFORMATION**

The states surveyed include *Florida, Illinois, Massachusetts, Michigan, Minnesota, and New York*. These states were selected due to their similarities to California's economy, business entity types, and tax laws.

*Florida* has no individual income tax; therefore, the CDC credit is not applicable.

*Illinois* and *Michigan* lack a credit or a deduction to taxpayers for child and dependent care expenses.

*Massachusetts* allows taxpayers a deduction that exceeds the federal limit on employment related expenses for dependent care services. Nonresidents and part-year residents must prorate this deduction based upon the amount of their Massachusetts-sourced income to total income.

*Minnesota* allows taxpayers a refundable credit similar to California's CDC credit. However, it is not a percentage of the federal CDC credit but instead is based on household income level. Nonresidents, part-year residents, and Native Americans must prorate the credit based on the amount of earned income taxable to Minnesota.

*New York* also allows taxpayers a refundable credit similar to California's CDC credit. It is based on a percentage of the federal CDC credit depending on the amount of the taxpayer's New York AGI. For nonresidents, the amount to be refunded is based on the New York income adjustments made to the federal AGI. For part-year residents, the amount to be refunded is based on the ratio of resident period income to the combined income from both the resident and nonresident periods.

**FISCAL IMPACT**

This bill would require a calculation for the credit that would require a new form or worksheet to be developed. As a result, this bill would impact the department's printing, processing, and storage costs for tax returns, instructions, and publications. These changes could be incorporated into the department's annual changes, and as such, the costs would be minor.

**ECONOMIC IMPACT**

Revenue Estimate

This bill would result in revenue losses as follows:

Estimated Revenue Impact of AB1990 For Taxable Years Beginning On or After January 1, 2011 Enactment Assumed By September 30, 2010 (\$ in Millions)		
2011-12	2012-13	2013-14
-\$44	-\$50	-\$55

This analysis does not consider the possible changes in investment activity, employment, personal income, or gross state product that could result from this bill.

**POLICY CONCERNS**

This bill fails to specify if the taxpayer could claim multiple benefits. It appears that a taxpayer could claim the credit proposed by this bill and the state Child Dependent Care credit. Both credits provide a benefit for the same expense. Generally, a credit is allowed in lieu of any deduction or credit already allowable for the same item of expense in order to eliminate multiple tax benefits.

This bill lacks a sunset date. Sunset dates generally are provided to allow periodic review of the effectiveness of the credit by the Legislature.

This bill would allow for an unlimited carryover period. Consequently, the department would be required to retain the carryover on the tax forms indefinitely. Recent credits have been enacted with a carryover period limitation because experience shows credits typically are exhausted within eight years of being earned.

## **LEGISLATIVE STAFF CONTACT**

Legislative Analyst

Angela Raygoza

(916) 845-7814

[angela.raygoza@ftb.ca.gov](mailto:angela.raygoza@ftb.ca.gov)

Revenue Manager

Monica Trefz

(916) 845-4002

[monica.trefz@ftb.ca.gov](mailto:monica.trefz@ftb.ca.gov)

Asst. Legislative Director

Patrice Gau-Johnson

(916) 845-5521

[patrice.gau-johnson@ftb.ca.gov](mailto:patrice.gau-johnson@ftb.ca.gov)