Franchise Tax Board

ANALYSIS OF AMENDED BILL

Author:	Nguyen	Analyst:	Davi Milam	Bill Number:	SB 268
Related Bills:	See Legislative History	Telephone:	845-2551	Introduced Date Amended Date:	February 19, 2015 March 23, 2015
		Attorney:	Bruce Langston	Sponsor	

SUBJECT:	Child & Dependent Care Expenses Credit

SUMMARY

Under the Personal Income Tax Law (PITL), this bill would raise the cap on expenses for the child and dependent care credit.

RECOMMENDATION

No position.

Summary of Amendments

The March 23, 2015, amendments corrected a referencing error. As introduced February 19, 2015, this bill would raise the cap on expenses for the child and dependent care credit. This is the department's first analysis of the bill.

REASON FOR THE BILL

The reason for this bill is to make childcare more affordable for working families by increasing the amount of qualifying expenses.

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, 2015.

FEDERAL/STATE LAW

Federal Law

Existing federal law allows a tax credit of 20 to 35 percent (depending on the taxpayer's adjusted gross income (AGI)) of employment-related costs of care for a qualifying individual.[1] A qualifying individual is defined as a dependent of the taxpayer that is under the age of 13 or a dependent or spouse who is physically or mentally unable to provide self-care. Employment-related expenses are generally defined as those expenses incurred to enable gainful employment. These

[1] Internal Revenue Code (IRC) section 21.

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expenses are limited to the lesser of the taxpayer's earned income or $3,000 per taxable year for one qualifying individual, or $6,000, if there are two or more qualifying individuals.

State Law

State law allows a credit similar to the federal child and dependent care credit.[2] In general, California conforms to federal law regarding qualifying individuals and the maximum amount and types of expenses eligible for the credit. However, state law limits expenses to care provided in California, and for purposes of the earned income limitation, uses earned income from California sources.

The state credit is computed by first applying the federal credit percentage (20 to 35 percent) to the smallest of three amounts: the expense cap, California expenses, or California earned income. The state credit percentage is then applied.

The state credit percentage varies based on the taxpayer's AGI, and is limited to taxpayers with AGI of $100,000 or less.

If AGI[3] is:	Credit Percentage:
$40,000 or less	50%
Over $40,000 but not over $70,000	43%
Over $70,000 but not over $100,000	34%
Over $100,000	0%

THIS BILL

For each taxable year beginning on or after January 1, 2015, this bill would raise the cap on employment-related expenses for child and dependent care that may be taken into account in computing the state credit, as follows:

Number of qualifying children	Current expense cap	Increased expense cap
1 qualifying child	$3,000	$4,000
2 or more qualifying children	$6,000	$12,000

[2] Revenue and Taxation Code (R&TC) section 17052.6 & IRC section 21.
[3] R&TC section 17024.5(h)(2) provides that for purposes of computing limitations, AGI means the amount required to be shown on the federal tax return for the same taxable year. In addition, for Registered Domestic Partners (RDPs) or former RDPs, AGI on the federal return is computed as if the RDP or former RDP was treated as a spouse or former spouse and used the same filing status that was used on the state tax return for the same taxable year.

Although this bill would raise the expense cap for state purposes, the state creditable amount would continue to be limited to actual California expenses, the expense cap, or California earned income, whichever is smallest. Additionally, the actual state tax credit amount would be computed by applying the federal credit percentage, and then the state credit percentage, as discussed under State Law.

IMPLEMENTATION CONSIDERATIONS

Implementing this bill would require some changes to existing tax forms and instructions and information systems, which could be accomplished during the normal annual update.

LEGISLATIVE HISTORY

SB 86 (Senate Budget and Fiscal Review Committee, Chapter 14, Statutes of 2011) made the credit for child and dependent care expenses nonrefundable for taxable years beginning on or after January 1, 2011.

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 does not have a personal income tax, and therefore does not provide a tax credit comparable to the credit this bill would allow.

Illinois, Massachusetts, and *Michigan* do not offer a child and dependent care expense credit; however, *Massachusetts* offers a deduction for child and dependent care expenses.

Minnesota and New York offer a refundable child and dependent care expense credit.

FISCAL IMPACT

This bill would not significantly impact the department's costs.

ECONOMIC IMPACT

Revenue Estimate

This bill would result in the following revenue loss:

Estimated Revenue Impact of SB 268 As Amended March 23, 2015 Assumed Enactment After June 30, 2015 ($ in Millions)		
2015-16	2016-17	2017-18
- $7.8	- $8.1	- $8.3

This analysis does not account for changes in employment, personal income, or gross state product that could result from this bill.

Revenue Discussion

Using data captured from Franchise Tax Board (FTB) Forms 3506 Child and Dependent Care Expenses Credit, the amount of credit each taxpayer could claim was recalculated to allow for the increase in expenses for household and dependent care services necessary for gainful employment specified in the bill. It was determined the changes would increase the amount of credit claimed by $6.4 million in 2012. This figure was grown[4] and adjusted upward by 15 percent to account for taxpayers who only reported the maximum allowable expenses under current law, even though the expenses incurred exceeded the cap. This results in a $7.8 million loss for 2015.

The tax year estimate is converted to fiscal year estimates, and then rounded to arrive at the estimates shown in the table above.

SUPPORT/OPPOSITION

Support: None provided.

Opposition: None provided.

ARGUMENTS

Proponents: Some may say that in a time when many low- to middle-income working families struggle to pay for the rising cost of childcare, this credit would make childcare more affordable to these families.

Opponents: Some may argue that increasing a tax credit limited to low- to middle-income recipients may be overly narrow and inadvertently exclude other Californians that need assistance.

POLICY CONCERNS

For taxpayers with two or more qualifying children, this bill could double the amount of expenses eligible for the state credit as compared to the federal credit. As a result, this state tax credit could be considered to provide a greater proportionate benefit for state tax purposes than for federal tax purposes.

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[4] Indexed using Department of Finance forecasts.