

ANALYSIS OF AMENDED BILL

Author: Jackson Analyst: Davi Milam Bill Number: SB 670
 See Legislative
 Related Bills: History Telephone: 845-2551 Amended Dates: April 23 & May 13, 2015
 Attorney: Bruce Langston Sponsor _____

SUBJECT:	Child & Dependent Care Expenses Credit/ Employer Child Care Program Startup Expenses Credit & Contributions to Qualified Care Plan Credit/FTB Report to Legislature
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SUMMARY

This bill would do the following:

- Provision 1:** Increase the state credit percentages for the Child and Dependent Care Expense Credit (Child Care Credit).
- Provision 2:** Allow a credit for employer child care facility start-up expenses (Employer Child Care Credit).
- Provision 3:** Allow a credit for contributions to a qualified child care plan (Contributions Credit).

RECOMMENDATION

No position.

Summary of Amendments

The April 23, 2015, amendments removed legislative intent language and added the provisions discussed in this analysis. The May 13, 2015, amendments made technical changes. This is the department’s first analysis of the bill.

REASON FOR THE BILL

The reason for this bill is to increase access to affordable childcare for working mothers and to support California businesses’ efforts to establish child care programs.

EFFECTIVE/OPERATIVE DATE

As a tax levy, this bill would be effective immediately upon enactment. The operative dates of the provisions vary and are addressed separately for each provision.

Board Position:	Executive Officer	Date
_____ S _____ NA _____ X _____ NP	Selvi Stanislaus	06/01/15
_____ SA _____ O _____ NAR		
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ECONOMIC IMPACT – SUMMARY REVENUE TABLE

Revenue Estimate

This bill would result in the following revenue loss:

Estimated Revenue Impact of SB 670 As Amended May 13, 2015 Enactment Assumed After June 30, 2015 (\$ in Millions)			
	2015-16	2016-17	2017-18
Provision 1: Child Care Credit	N/A	-\$3.6	-\$3.6
Provision 2: Employer Child Care Credit	-\$0.1	-\$0.6	-\$0.7
Provision 3: Contributions Credit	-\$0.4	-\$3.7	-\$4.1
Total	-\$0.5	-\$7.9	-\$8.4

PROVISION 1: Child Care Credit

EFFECTIVE/OPERATIVE DATE

This provision would be immediately effective and specifically operative for taxable years beginning on or after January 1, 2016.

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 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 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.

¹ Internal Revenue Code (IRC) section 21.

² Revenue and Taxation Code (R&TC) section 17052.6 & IRC section 21.

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.

<u>If AGI³ is:</u>	<u>Credit Percentage:</u>
\$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 PROVISION

For each taxable year beginning on or after January 1, 2016, this provision would change the Child Care Credit's state credit percentages as follows:

If AGI is:	Current Credit Percentage	Increased Credit Percentage
\$40,000 or less	50%	63%
Over \$40,000 but not over \$70,000	43%	53%
Over \$70,000 but not over \$100,000	34%	42%
Over \$100,000	0%	0%

IMPLEMENTATION CONSIDERATIONS

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

TECHNICAL CONSIDERATIONS

On page 3, lines 31 and 32, the IRC relating to language should be corrected by striking "age requirements" and inserting "child defined".

On page 3, line 40 through page 4, line 2, the language removed by the amendment should be reinserted.

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.

On page 4, lines 2 and 3, the language added by the amendment is unnecessary and should be removed.

LEGISLATIVE HISTORY

SB 268 (Nguyen, 2015/2016), would amend the Child Care Credit by raising the expense cap and the AGI limitations related to the state credit percentages. SB 268 is pending before the Senate Appropriations Committee.

SB 86 (Senate Budget and Fiscal Review Committee, Chapter 14, Statutes of 2011) made the Child Care Credit 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 provision would allow.

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

Minnesota and New York offer a refundable child care credit.

FISCAL IMPACT

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

ECONOMIC IMPACT

Revenue Estimate

This provision would result in the following revenue loss:

Estimated Revenue Impact of SB 670 – Child Care Credit As Amended May 13, 2015 Enactment Assumed After June 30, 2015 (\$ in Millions)			
	2015-16	2016-17	2017-18
Provision 1: Child Care Credit	N/A	-\$3.6	-\$3.6

Revenue Discussion

Using data captured from California Form 3506, Child and Dependent Care Expenses Credit, the percentage of the federal credit each taxpayer could claim was recalculated to apply the proposed credit percentages. It was determined the changes would increase the amount of credit claimed by \$3.3 million in 2012.

The tax year estimates are grown,⁴ converted to fiscal year estimates, and then rounded to arrive at the estimates shown in the table above.

PROGRAM BACKGROUND

Until December 1, 2011, prior law allowed both the Employer Child Care Credit and the Contributions Credit (discussed in Provisions 2 and 3 below).

The Franchise Tax Board (FTB) was required to report to the Legislature by January 1, 2011, the following information:

The amount of the Employer Child Care Credit claimed each year was approximately \$400,000 and the estimated average number of children served each year was 1,400:

Tax Year	Credit Claimed	Children Served
2007	\$410,000	1,200
2008	\$490,000	1,900
2009	\$410,000	1,100
2010	\$370,000 (partial year)	600 (partial year)

The amount of Contributions Credit claimed each year was approximately \$2,700,000 and the estimated average number of children served each year was just over 8,700:

Tax Year	Credit Claimed	Children Served
2007	\$2,500,000	8,000
2008	\$2,800,000	9,000
2009	\$2,900,000	9,300
2010	\$2,400,000 (partial year)	7,900 (partial year)

PROVISION 2: Employer Child Care Facility Startup Expenses Credit (Employer Child Care Credit)

EFFECTIVE/OPERATIVE DATE

This provision would be immediately effective and specifically operative for taxable years beginning on or after January 1, 2016, and before January 1, 2021.

⁴ Indexed using Department of Finance (DOF) forecasts.

Federal Law

Federal law allows tax credits equal to 25 percent of qualified expenses for employee child care and 10 percent of qualified expenses for child care resource and referral services. The maximum total credit that may be claimed by a taxpayer cannot exceed \$150,000 per taxable year.

Qualified child care expenses include costs paid or incurred (1) to acquire, construct, rehabilitate, or expand property that is to be used as part of the taxpayer's qualified child care facility, (2) for the operation of the taxpayer's qualified child care facility, including the costs of training and certain compensation for employees of the child care facility, and scholarship programs; or (3) under a contract with a qualified child care facility to provide child care services to employees of the taxpayer.

Qualified child care resource and referral expenses are amounts paid or incurred under a contract to provide child care resource and referral services to the employees of the taxpayer.

State Law

Existing state law provides various tax credits designed to provide tax relief for taxpayers who incur certain expenses (e.g., child adoption) or to influence behavior, including business practices and decisions (e.g., research credits or economic development area hiring credits). These credits generally are designed to provide incentives for taxpayers to perform various actions or activities that they may not otherwise undertake.

There are currently no state credits comparable to the credit that would be allowed by this provision.

THIS PROVISION

Under the Personal Income Tax Law (PITL) and the Corporation Tax Law (CTL), for each taxable year beginning on or after January 1, 2016, and before January 1, 2021, this provision would allow a credit equal to 30 percent of any of the following:

- The cost paid or incurred by the taxpayer on or after January 1, 2016, for the startup expenses of establishing a child care program or constructing a child care facility in California, to be used primarily by the children of the taxpayer's employees.
- The cost paid or incurred on or after January 1, 2016, for startup expenses of establishing a child care program or constructing a child care facility in California, to be used primarily by the children of employees of tenants leasing commercial or office space in a building owned by the taxpayer.
- The cost paid or incurred by the taxpayer on or after January 1, 2016, for contributions to California child care information and referral services, including but not limited to those that identify local child care services, offer information describing these resources to the taxpayer's employees, and make referrals of the taxpayer's employees to child care services where there are vacancies. In the case of a child care facility established by two or more taxpayers, the credit would be allowed to each taxpayer if the facility is to be used primarily by the children of the employees of each of the taxpayers or the children of the employees of the tenants of each of the taxpayers.

This provision would provide:

- The amount of the credit could not exceed \$50,000 for the taxable year.
- If two or more taxpayers share in the costs eligible for the credit, each taxpayer would be eligible to receive a tax credit with respect to his, her, or its respective share of the costs paid or incurred.
- Any excess credit could be carried over until exhausted.
- Any credit carryover amount could be added to any credit for the succeeding taxable year; however, the aggregate amount allowable in any taxable year would still be limited to fifty thousand dollars (\$50,000).
- In lieu of claiming the tax credit, the taxpayer may elect to take depreciation.⁵ In addition, the taxpayer may take depreciation for the cost of a facility in excess of the amount of the tax credit claimed.

The basis of any child care facility for which a credit is allowed would be reduced by the amount of the credit attributable to the facility. The basis adjustment would be made for the taxable year for which the credit is allowed. A taxpayer required by any local ordinance or regulation to provide a child care facility would be ineligible for the credit.

Upon request of the FTB, the taxpayer would be required to submit a statement certifying that the costs for which the credit is claimed were incurred for startup expenses of establishing a child care program or constructing a child care facility in California to be used primarily by the children of the taxpayer's employees or the children of the employees of tenants leasing commercial or office space in a building owned by the taxpayer and which will be in operation for at least 60 consecutive months after completion.

If the taxpayer disposes of or ceases to operate the child care center within 60 months after completion, that portion of the credit claimed which represents the remaining portion of the 60-month period would be added to the taxpayer's tax liability in the taxable year of that disposition or nonuse.

This provision would require the taxpayer to indicate, in the form and manner prescribed by the FTB, the number of children that the child care program or facility will be able to legally accommodate.

For purposes of this credit, "startup expenses" would include, but would not be limited to, feasibility studies, site preparation and construction, renovation, or acquisition of facilities for purposes of establishing or expanding onsite or nearsite centers by one or more employers or one or more building owners leasing space to employers.

⁵ Pursuant to Revenue and Taxation Code (R&TC) section 17250. A comparable election is unavailable under the CTL.

On or before January 1, 2018, the FTB would be required to submit to the Legislature the following information:

- The dollar amount of credits claimed annually.
- The number of child care facilities established or constructed by taxpayers claiming the credit.
- The number of children served by these facilities.

The report would be required to be submitted in compliance with Section 9795 of the Government Code.⁶

Section 41 would not apply to this credit.⁷

This provision would remain in effect until December 1, 2021, and as of that date would be repealed.

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 provision would allow multiple taxpayers to claim the full amount of the credit for the same child care facility. If this is inconsistent with the author's intent, the bill should be amended.

Under the PITL, taxpayers would be allowed to elect to take depreciation in lieu of the credit. This election would be unavailable to those taxpayers eligible for the credit under the CTL. If this is inconsistent with the author's intent, the bill should be amended.

FISCAL IMPACT

The department's costs to implement this provision have yet to be determined. As the bill moves through the legislative process and the implementation concerns are resolved, costs will be identified and an appropriation will be requested, if necessary.

⁶ Generally, reports to the Legislature must be submitted as a printed copy to the Secretary of the Senate, as an electronic copy to the Chief Clerk of the Assembly, and as an electronic or printed copy to the Legislative Counsel.

⁷ R&TC section 41 requires a bill introduced to authorize a new tax credit to include specific goals, purposes, objectives, and performance measures.

ECONOMIC IMPACT

Revenue Estimate

This provision would result in the following revenue loss:

Estimated Revenue Impact of SB 670 – Employer Child Care Credit As Amended May 13, 2015 Enactment Assumed After June 30, 2015 (\$ in Millions)			
	2015-16	2016-17	2017-18
Provision 2: Employer Child Care Credit	-\$0.1	-\$0.6	-\$0.7

Revenue Discussion

The Employer Child Care Credit amounts were estimated using data collected by the department from the prior Employer Child Care Credit that sunset January 1, 2012. On average, taxpayers claimed \$500 thousand each tax year for the Employer Child Care Credit.

The tax year estimates were grown,⁸ converted to fiscal year estimates, and then rounded to arrive at the estimates shown in the table above.

PROVISION 3: Contributions to Qualified Care Plan Credit (Contributions Credit)

EFFECTIVE/OPERATIVE DATE

This provision would be effective immediately and specifically operative for taxable years beginning on or after January 1, 2016, and before January 1, 2021.

FEDERAL/STATE LAW

There are currently no federal or state credits comparable to the credit that would be allowed by this provision.

THIS PROVISION

Under the PITL and the CTL, for each taxable year beginning on or after January 1, 2016, and before January 1, 2021, this provision would allow a credit equal to 30 percent of the cost paid or incurred by the taxpayer for contributions to a qualified care plan made on behalf of any qualified dependent of the taxpayer’s qualified employee, not to exceed \$360 for each qualified dependent.

This provision would define the following terms and phrases:

- “Qualified care plan” means a plan providing qualified care.

⁸ Indexed using DOF forecasts.

- “Qualified care” includes, but is not limited to, onsite service, center-based service, in-home care or home-provider care, and a dependent care center as defined by IRC section 21(b)(2)(D) that is a specialized center with respect to short-term illnesses of an employee’s dependents. “Qualified care” must be provided in this state under the authority of a license when required by California law.
- “Specialized Centers” means a facility that provides care to mildly ill children and that may do all of the following:
 - (A) Be staffed by pediatric nurses and day care workers.
 - (B) Admit children suffering from common childhood ailments (including colds, flu, and chickenpox).
 - (C) Make special arrangements for well children with minor problems associated with diabetes, asthma, breaks or sprains, and recuperation from surgery.
 - (D) Separate children according to their illness and symptoms in order to protect them from cross-infection.
- “Contributions” include direct payments to child care programs or providers, but would not include amounts contributed to a qualified care plan pursuant to a salary reduction agreement to provide benefits under a dependent care assistance program.⁹
- “Qualified employee” means any employee of the taxpayer who is performing services for the taxpayer in this state, within the meaning of Section 25133, during the period in which the qualified care is performed.
- “Employee” includes an individual who is an employee within the meaning of IRC section 401(c)(1), relating to self-employed individual treated as an employee.
- “Qualified dependent” means any dependent of a qualified employee who is under 12 years of age.

This provision also would provide the following:

- If an employer makes contributions to a qualified care plan and also collects fees from parents to support a child care facility owned and operated by the employer, a credit would not be allowed for contributions in the amount, if any, by which the sum of the contributions and fees exceed the total cost of providing care. The FTB could require information about fees collected from parents of children served in the facility from taxpayers claiming credits under this provision.
- If the duration of the child care received is less than 42 weeks, the employer would claim a prorated portion of the allowable credit using the ratio of the number of weeks of care received divided by 42 weeks.

⁹ Within the meaning of IRC section 129, as applicable, for purposes of Part 11 (commencing with Section 23001) and this part.

- An employer would be ineligible for the credit if the care provided on behalf of an employee is provided by an individual who:
 - Qualifies as a dependent of that employee or that employee's spouse.¹⁰
 - Is a son, stepson, daughter, or stepdaughter of that employee¹¹, and is under 19 years of age at the close of that taxable year.

This provision also would provide:

- Contributions to a qualified care plan could not discriminate in favor of employees who are officers, owners, or highly compensated, or their dependents.
- That portion of expenses paid or incurred for the taxable year that is equal to the amount of the credit allowed under this provision would be ineligible for deduction.
- The basis of the facility would be reduced by the amount of the credit in the taxable year the credit is allowed.
- The taxpayer would be required to provide, in the form and manner requested by the FTB, the number of children of employers served by the qualified child care plan.

The FTB would be required, on or before January 1, 2018, to report to the Legislature the following information:

- The dollar amount of credits claimed annually.
- The number of children of employees served by the qualified care plan for which the taxpayer claimed a credit.

The report would be required to be submitted in compliance with Section 9795 of the Government Code.¹²

Any excess credit could be carried over until exhausted.

Section 41 would not apply to the credit.¹³

This provision would remain in effect only until December 1, 2021, and would be repealed as of that date.

¹⁰ Under R&TC section 17054(d).

¹¹ Within the meaning of R&TC section 17056.

¹² Generally, reports to the Legislature must be submitted as a printed copy to the Secretary of the Senate, as an electronic copy to the Chief Clerk of the Assembly, and as an electronic copy to the Legislative Counsel.

¹³ R&TC section 41 requires a bill introduced to authorize a new tax credit to include specific goals, purposes, objectives, and performance measures.

IMPLEMENTATION CONSIDERATIONS

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

FISCAL IMPACT

The department's costs to implement this provision have yet to be determined. As the bill moves through the legislative process, costs will be identified and an appropriation will be requested, if necessary.

ECONOMIC IMPACT

Revenue Estimate

This provision would result in the following revenue loss:

Estimated Revenue Impact of SB 670 – Contributions Credit As Amended May 13, 2015 Enactment Assumed After June 30, 2015 (\$ in Millions)			
	2015-16	2016-17	2017-18
Provision 3: Contributions Credit	- \$0.4	- \$3.7	- \$4.1

Revenue Discussion

The Contributions Credit amounts were estimated using data collected by the department on the prior Contributions Credit that sunset on January 1, 2012. On average, taxpayers claimed \$2.8 million each tax year for the Contributions Credit.

The tax year estimates were grown,¹⁴ converted to fiscal year estimates, and then rounded to arrive at the estimates shown in the table above.

LEGISLATIVE HISTORY

AB 1282 (Mullin, Chapter 712, Statutes of 2006), extended the sunset date of the Employer Child Care Credit and the Contributions Credit to January 1, 2012.

SB 549 (Ortiz, 1999/2000) would have increased the rate of the Employer Child Care Credit from 30 percent to 70 percent for a facility registering low-income children. SB 549 failed to pass out of the Senate Appropriations Committee.

¹⁴ Indexed using DOF forecasts.

AB 866 (Diaz, Chapter 650, Statutes of 2010), extended the sunset date of the Employer Child Care Credit and the Contributions Credit to January 1, 2007.

SB 722 (Chapter 1239, Statutes of 1988) enacted the Employer Child Care Credit and the Contributions Credit.

OTHER STATES' INFORMATION

A review of *Florida, Massachusetts, Michigan, Minnesota, and New York* tax laws found no comparable tax credits or deductions. These states were reviewed because of the similarities between California income tax laws and their tax laws.

Illinois allows corporations to take either a Dependent Care Assistance Program Credit for employers that provide an on-site facility for dependent care assistance or an Employee Child Care Credit for employers that provide an on-site child care facility for employees. Employers may only take one of these credits, which are limited to 5 percent of the expenses incurred from providing these services to employees.

SUPPORT/OPPOSITION¹⁵

Support: Bay Area Council.

Opposition: None provided.

ARGUMENTS

Proponents: Some may say that in a time when families struggle to pay for the rising cost of childcare, this credit would improve the availability of affordable, quality childcare for these families.

Opponents: Some may argue that providing an employer tax credit may be an inefficient way to improve the availability of affordable childcare.

POLICY CONCERNS

Provisions two and three 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.

¹⁵ As noted in SB 670 Fact Sheet.

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