Franchise Tax Board

ANALYSIS OF ORIGINAL BILL

Author:	Ortiz	Analyst:	Kimberly Pantoja	Bill Number:	SB 549
Related Bills:	See Legislative History	Telephone:	845-4786	Introduced Date:	02/19/99
		Attorney:	Doug Bramhall	Sponsor:	

SUBJECT: Employer Child Care Credit/70% Of Costs for Facilities Serving Low-Income Children/Bank Loans Credit

SUMMARY

Under the Personal Income Tax Law (PITL) and the Bank and Corporation Tax Law (B&CTL), this bill would increase the rate of the Employer Child Care Program Credit from 30% to 70% for a facility registering low-income children. This bill also would include the Employer Child Care Program Credit in the list of credits that can reduce regular tax below tentative minimum tax (TMT) for purposes of alternative minimum tax calculation.

Under the B&CTL, this bill also would allow a credit equal to 50% of the difference between interest income received on specified loans relating to financing qualified child care and development facilities and the interest that would have been received had the loan been made at one point above the prime rate.

These provisions will be discussed separately.

1. EMPLOYER CHILD CARE PROGRAM CREDIT

EFFECTIVE DATE

This provision would apply to taxable or income years beginning on or after January 1, 1999, and before January 1, 2003.

LEGISLATIVE HISTORY

AB 401 (1999/2000); AB 2798 (Stats. 1998, Ch. 323); SB 722 (Stats. 1988, Ch. 1239); AB 802 (Stats. 1989, Ch. 1352); SB 227 (Stats. 1991, Ch. 476); SB 1863 (Stats. 1992, Ch. 816); AB 2688 (1994); AB 3144 (Stats. 1994, Ch. 748); AB 642 (1997).

SPECIFIC FINDINGS

Existing federal and state law provide for an alternative minimum tax liability, which ensures that taxpayers with credits, deductions, and other tax preference items do not completely escape taxation.

Existing state law allows employers a tax credit, known as the Employer Child Care Program Credit, equal to 30% of the cost paid or incurred for (1) establishing a child care program or constructing a child care facility in California to be used by their employees' children and (2) contributing to child

Board Position:			Department Director	Date
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care information and referral services. Building owners also are allowed a credit equal to 30% of their costs to establish a child care program or facility to be used by their tenants' employees' children. The amount of the credit is limited to $50,000, even if 30% of the taxpayer's expenses exceeds $50,000. To the extent that the allowed credit cannot be used, a credit carryover is permitted. The carried-over amount may be added to any credit for that succeeding year, which is still limited to $50,000.

Existing state law allows employers a tax credit, known as the Employer Child Care Contribution Credit, equal to 30% of the cost paid or incurred for contributions to a qualified care plan made on behalf of any dependent under the age of 12 of the taxpayer's California employee, but only to the extent contributions are made directly to child care programs or providers. The amount of the credit cannot exceed $360 in any year for each qualified dependent and any unused credit may continue to be carried forward, even beyond the repeal date, until it has been exhausted.

This bill would allow a credit equal to 70% of the taxpayer’s costs to establish a child care program or facility if at least 51% of children registered in a facility are from households that have incomes below 75% of the local area median income, as published by the United States Department of Housing and Urban Development (HUD). Although the credit rate would increase from 30% to 70% for qualifying facilities, the $50,000 limit would still apply.

This bill also would include the Employer Child Care Program Credit in the list of credits that can reduce regular tax below tentative minimum tax for purposes of alternative minimum tax calculation.

Policy Consideration

Existing law requires facilities to be used **primarily** by the children of the taxpayer's employees, while this bill would increase the rate of the credit from 30% to 70% for a facility if at least **51%** of the children registered in the facility are from low-income households. However, the restriction regarding employee's children would still apply. It's unclear whether a facility could meet both requirements.

Implementation Considerations

This bill does not require documentation of the income of the registered children (or their households), thereby causing potential audit problems. Also, it may be difficult for the facility to obtain the annual income information from the registrants. Finally, the bill contemplates the loss of the increased credit amount if the income restrictions are not met for any month during the taxable year. If this verification is conducted upon audit of the credit, it may be impossible to verify the income restrictions. An ongoing independent verification may be required to avoid disputes between the department and taxpayers.

After these concerns are resolved, implementation of this bill should not significantly impact the department.

FISCAL IMPACT

Departmental Costs

Once the implementation concerns are resolved, this provision is not expected to impact the department's costs.

Tax Revenue Estimate

Revenue losses from this provision are estimated as follows:

Effective For Income/Taxable Years Beginning on or After January 1, 1999 Enactment Assumed After June 30, 1999 (In Millions)				
	1999-0	2000-1	2002-3	2003-4
Increase Credit to 70%	($0.5)	($0.5)	($0.5)	($0.5)

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

Tax Revenue Discussion

Revenue losses under the PITL and the B&CTL will depend on qualified start-up expenses for child care programs or constructing a child care facility and the ability to apply credits against available tax liabilities.

Actual tax data for the 1996 taxable/income year indicate $1.5 million in applied credits for qualified start-up expenses or constructing a child care facility. The larger credit (70% instead of 30%), not to exceed $50,000, for facilities predominantly used by low-income households would increase losses by approximately $500,000 annually. This allows for the credit reducing regular tax below TMT for all taxpayers.

2. CREDIT FOR INTEREST INCOME ON CHILD CARE AND DEVELOPMENT FACILITIES

EFFECTIVE DATE

This provision would apply to income years beginning on or after January 1, 1999.

SPECIFIC FINDINGS

Existing state law allows a similar credit for interest income on loans used to finance qualified expenditures for farmworker housing. **Existing state law** also allows taxpayers who make loans to businesses within an Enterprise Zone to deduct net interest.

This bill would allow a credit for 50% of the difference between the interest income received on specified loans relating to financing qualified child care and development facilities and the interest that would have been received had the loan been made at one point above the prime rate.

The credit allowed by this provision shall be taken in equal installments over a period equal to the lesser of 10 years or the term of the loan, beginning in the taxpayer's income year during which the qualified child care facility construction is completed and there is initial enrollment of children by the child care or child development program. In the case where this credit exceeds the taxpayer's tax liability, the excess may be carried over until the credit is exhausted.

The credit shall not apply to loans with a term of less than three years or to loans funded prior to January 1, 1999. The credit shall apply only to interest income from the loan and shall not apply to any other loan fees or other charges collected by the bank or financial corporation with respect to the loan.

"Qualified facility" is defined as a licensed child care or development facility that meets both of the following requirements:

- Is operated by child care providers who covenant to a bank or financial institution to provide child care services for the entire term of the loan; and
- Is located in low- or moderate-income areas as defined by the Community Reinvestment Act of 1977 (Public Law 95-128), as amended; <u>or</u> is operated by child care providers whose loan covenant with the banking or financial institution provides that not less than 30% of the children served by the facility will be from households with incomes at or below 75% of the local median income, as published by HUD.

Family day care centers are not qualified facilities.

This credit shall not apply to loans for purchasing real property or for refinancing existing loans.

A taxpayer would be disallowed all credit that would accrue after the occurrence of a disallowing event. A disallowing event is one in which the child care provider is either in default of payment for more than 90 days or ceases providing child care in the facility for which the loan was made for more than 90 days, or both, unless the center takes action to accelerate the loan. The state may seek to recapture any credit claimed that is disallowed by this provision.

The credit may not be claimed for any project receiving funding or subsidy from the Child Care and Development Facilities Loan Guaranty or Direct Loan Funds, as contained in Sections 8277.5 and 8277.6 of the Education Code.

Generally, if the bank or financial corporation sells the loan to another bank or financial corporation, the balance of the credit, if any, shall be transferred to the assignee or transferee of the loan, subject to the same conditions and limitations of the credit. A bank or financial corporation may assign, sell, or otherwise transfer the loan to another person or entity and retain the right to claim the credit granted under this section if the bank or financial corporation retains responsibility for servicing the loan.

<u>Policy Considerations</u>

This provision does not specify a repeal date for the credit or limit the number of years for the carryover. Credits are typically enacted with a repeal date to ensure that the Legislature reviews its effectiveness. Also, departmental experience indicates that credits are typically used within eight years of being earned. Recent credits have been enacted with a carryover period limitation so the department is not required to retain the credit carryover on the tax form indefinitely after its repeal date.

The bill could be considered internally inconsistent. While the credit requires borrowers to promise lenders to provide child care and, if not located in a low- or moderate-income area, to additionally promise to provide child care to children from low- and moderate-income households, the credit is disallowed only if child care is no longer provided in the facility. Once the center is qualified, the credit is not disallowed if child care is provided only to moderate or upper income children.

This credit is attempting to provide an incentive to lenders to lend for child care facilities for low-income registrants and to taxpayers building and improving child care centers for that income group to continue to provide the child care over the life of the loan. As drafted, the language provides that behavior of the borrower affects the lender's ability to take the credit. The lender would have to demonstrate compliance by the borrower if audited. Because of this, the incentive to the lender to make such loans is diminished.

Implementation Considerations

Generally, the term "real property" in tax law means the land and the structure permanently affixed to the land. Therefore, to avoid confusion the term "real property" should be changed to "land." Amendment 3 has been provided to make this clarification.

The credit is to be claimed in equal installments over a period equal to "the lesser of 10 years or the term of the loan." If the taxpayer accelerates payments and the loan is paid off prior to period that the credit is allowed, it is unclear if the bank or financial corporation could accelerate claiming the balance of the credit, would continue to claim the credit over the specified period, or would lose the unclaimed portion of the credit.

The credit is for reduced interest on portions of loans used to “purchase, construct, expand, or rehabilitate” a qualified child care or development facility, beginning in the year the child care facility construction is completed and there is initial enrollment. Since the credit is provided for loans to “purchase, expand, or rehabilitate” as well as construct, it is unclear which year is the first year for credit based on purchase, expansion, or rehabilitation. In addition, the language could be interpreted to operate so as to limit the credit to loans for the construction of a qualified child care facility. Amendments 1 and 2 have been provided to clarify these matters.

The recapture of credit claimed is a reporting requirement of the taxpayer, not the affirmative duty of the state. Amendments 4 and 5 have been provided to clarify this requirement.

FISCAL IMPACT

Departmental Costs

Once the implementation concerns are resolved, this provision is not expected to impact the department's costs.

Tax Revenue Estimate

Revenue losses from this provision are estimated as follows:

Effective With Income/Taxable Years Beginning on or After January 1, 1999 Enactment Assumed After June 30, 1999 (In Millions)				
	1999-0	2000-1	2002-3	2003-4
Tax Credit to Lenders	Negligible	Minor	Minor	($0.5)

Negligible = Loss Less Than $250,000
Minor = Loss Less Than $500,000

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

Tax Revenue Discussion

Revenue losses under the PITL and the B&CTL will depend on lenders providing qualified loans and the ability to apply credits against available tax liabilities.

This estimate is provided as a rule of thumb for every $50 million in annual qualified loans with an average discount rate of 1%.

BOARD POSITION

Neutral.

At its March 23, 1999, meeting, the Franchise Tax Board voted 2-0 to take a neutral position on this bill.

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FRANCHISE TAX BOARD'S
PROPOSED AMENDMENTS TO SB 549
As Introduced February 19, 1999

AMENDMENT 1

On page 17, line 3 strike out "care facility construction" and insert:

care or development facility is purchased or construction, expansion, or rehabilitation of the facility

AMENDMENT 2

On page 17, line 17, strike out "qualified facility" and insert:

"qualified child care or development facility"

AMENDMENT 3

On page 17, line 36, strike "real property" and insert:

land

AMENDMENT 4

On page 17, strike lines 37 through 40, inclusive.

AMENDMENT 5

On page 18, strike lines 1 through 5, and insert:

(d)(1) Upon the occurrence of a disallowing event, no installment of the credit shall be allowed under this section for the income year of a disallowing event and any subsequent income year of the period provided in paragraph (2) of subdivision (b).
(2) For purposes of this subdivision, a "disallowing event" means either:
(A) The child care provider is in default under the loan agreement for more than 90 days.
(B) The child care provider ceases providing child care services in the facility for which the loan was made for more than 90 days.
(C) In the case of a credit based on loan covenants described in clause (ii) of subparagraph (B) of paragraph (1) of subdivision (c), the child care provider

ceases providing child care services in compliance with that loan covenant for more than 90 days.