

## **TITLE 18. FRANCHISE TAX BOARD**

As required by Government Code section 11346.4, this is notice that a public hearing has been scheduled to be held at 10:00 a.m., April 18, 2013, at the Franchise Tax Board, 9646 Butterfield Way, Sacramento, California, to consider the addition of Section 17052.6 under Title 18 of the California Code of Regulations ("Regulation"), pertaining to the Child and Dependent Care Expenses (CDC) Credit.

An employee of the Franchise Tax Board (the "Board") will conduct the hearing. Interested persons are invited to present comments, written or oral, concerning the proposed regulatory action. It is requested, but not required, that persons who make oral comments at the hearing also submit a written copy of their comments at the hearing.

Government Code section 15702, subdivision (b), provides for consideration by the three-member Franchise Tax Board of any proposed regulatory action if any person makes such request in writing.

### **WRITTEN COMMENT PERIOD**

Written comments will be accepted until 5:00 p.m., April 18, 2013. All relevant matters presented will be considered before the proposed regulatory action is taken. Comments should be submitted to the agency officer named below.

### **AUTHORITY AND REFERENCE**

Section 19503 of the Revenue and Taxation Code ("RTC") authorizes the Board to prescribe regulations necessary for the enforcement of Part 10 (commencing with section 17001), Part 10.2 (commencing with section 18401), Part 10.7 (commencing with section 21001), and Part 11 (commencing with section 23001) of the RTC. The proposed regulatory action interprets, implements, and makes specific RTC section 17052.6.

### **INFORMATIVE DIGEST/POLICY STATEMENT OVERVIEW**

#### Summary of Existing Laws and Regulations

RTC section 17052.6 provides that a CDC tax credit shall be allowed for taxable years beginning on or after January 1, 2000 in an amount equal to a percentage (based on federal adjusted gross income) of the federal CDC credit determined in accordance with Section 21 of the Internal Revenue Code. The federal CDC credit is a tax credit based on qualifying expenses incurred for the care of a qualifying person which made it possible for a taxpayer to work or to seek employment.

For taxable years beginning prior to January 1, 2011, the California CDC Credit is refundable. For taxable years beginning on or after January 1, 2011, the California CDC Credit is nonrefundable, so the credit cannot reduce tax liability below zero.

Treasury Regulation section 1.21-1(k) provides that a taxpayer claiming the CDC Credit must maintain adequate records or other sufficient evidence to substantiate the expenses "in accordance with section 6001 and the regulations thereunder." However, the federal regulations under Internal Revenue Code section 6001 lack the specificity of appropriate verifying documentation which the Franchise Tax Board has determined would benefit both claimant taxpayers and the Franchise Tax Board in determining eligibility for the CDC Credit under RTC section 17052.6.

### Objectives of and Anticipated Benefits from the Proposed Regulation

The objective of the proposed regulatory section is to provide clarity as to the records/documents that taxpayers can retain and provide upon request to establish entitlement to the CDC Credit. Through such clarity, the taxpayer will have the advantage of knowing what specific documents to obtain and retain, at the time that they are procuring their child or dependent care services, rather than at the time that they are later contacted by the Franchise Tax Board to provide such documentation, thus eliminating the challenge of retroactively collecting documentation sufficient to substantiate their claim for the CDC Credit.

### Evaluation of Proposed Regulation with Respect to Existing State Regulations

The Franchise Tax Board has evaluated and determined that adoption of the proposed regulation is not inconsistent with or incompatible with existing state regulations. There are no other comparable existing state regulations.

### Existing Comparable Federal Regulation

Treasury Regulation section 1.21-1(k) discusses records maintenance very generally by reference to Internal Revenue Code section 6001 and the regulations thereunder. The . This proposed regulation seeks to specifically identify the requirements for records and qualifying documentation for purposes of claiming the CDC credit as a means of assisting taxpayers and the Franchise Tax Board in verifying eligibility for the CDC Credit. These federal regulations under Internal Revenue Code section 6001 lack the specificity of appropriate verifying documentation which the Franchise Tax Board has determined would benefit both claimant taxpayers and the Franchise Tax Board in determining eligibility for the CDC Credit under RTC section 17052.6. The Franchise Tax Board has evaluated and determined that adoption of the proposed regulation is not inconsistent with or incompatible with existing federal regulations.

## **SPECIFIC PROPOSAL**

Subsection (a) of the regulation provides a general rule that a taxpayer must maintain adequate records to substantiate entitlement to the CDC Credit, as provided in the remainder of the regulation.

Subsection (b), made up of five subparts detailed individually below, provides a description of each legal requirement that the Franchise Tax Board looks to when verifying entitlement to the CDC Credit and specific documents that the taxpayer can provide to establish that each legal requirement is met.

- Subsection (b)(1) references the legal requirement that the care be provided to an individual, identified by a taxpayer identification number, that is the taxpayer's "qualifying person." As such, the qualifying person's identity, taxpayer identification number, and age must be established by the taxpayer. The subsection indicates that the qualifying person's birth certificate and Social Security Account Number card can establish that this legal requirement is met.
- Subsection (b)(2) references the legal requirement that the qualifying person be mentally or physically disabled if the qualifying person is thirteen or older. This subsection indicates that medical records that demonstrate the physical or mental incapacity of the qualifying person can establish that this legal requirement is met.
- Subsection (b)(3) references the legal requirement that the taxpayer establish their care provider's identity and taxpayer identification number. This subsection references documents that can be provided to establish identity and documents that can be provided to establish the taxpayer identification number.
- Subsection (b)(4) references the legal requirement that the care be provided within California. This subsection indicates that the provider's California driver's license or identification card reflecting the provider's California address or a utility bill in the provider's name for the address at which the care was provided can establish that this legal requirement is met. The subsection exempts taxpayers from providing this information if the care is provided within their home.
- Subsection (b)(5) speaks to the legal requirement that the taxpayer substantiate their care expenses. This subsection indicates that proof of payment such as canceled checks/money orders, receipts, invoices, or year-end statements can establish that this legal requirement is met.

Subsection (c) provides an alternative method of producing "other sufficient evidence" to establish compliance with the legal requirements set forth in subsection (b) when the taxpayer is unable to produce the specific documents identified in subsection (b).

Subsection (d) provides a standard for maintaining the specific records required by this regulation section through reference to Internal Revenue Code section 6001 and the regulations thereunder. Subsection (d) is consistent with the substantiation standard for claiming the federal CDC credit, set forth in Treasury Regulation section 1.21-1(k).

Subsection (e) provides that the taxpayer shall produce the records required by this regulation section upon the Franchise Tax Board's request. Subsection (e) further provides that the CDC credit will be denied in the event that the taxpayer fails to produce such records.

Subsection (f) provides five examples illustrating scenarios in which evidence which is not identified in subsection (b) is provided by a taxpayer to attempt to satisfy the legal requirements referenced in subsection (b).

- The example in subsection (f)(1) illustrates a scenario in which the taxpayer paid her care provider, an individual, in cash and did not have receipts for her payments. The taxpayer submits a notarized statement, signed under penalty of perjury, from her provider which confirms the amounts paid by the taxpayer for childcare services. The example in subsection (f)(1) provides that such a statement may be sufficient evidence under subsection (c) to establish the proof of payment required by subsection (b)(5).
- The example in subsection (f)(2) illustrates a scenario in which the taxpayer paid her care provider, an individual, in cash and did not have receipts for her payments. The taxpayer submits a federal form W-10, Dependent Care Provider's Identification and Certification, which is notarized and signed by the care provider, with a handwritten statement above the signature confirming the amounts paid by the taxpayer for childcare services. The example in subsection (f)(2) provides that while the W-10 may be sufficient evidence under subsection (c) to establish the provider's identity and taxpayer identification number, it is not sufficient to establish proof of payment required by subsection (b)(5).
- The example in subsection (f)(3) illustrates a scenario in which the qualifying person's care was provided in the child care provider's home by an individual care provider. The taxpayer submitted a notarized statement, signed under penalty of perjury, from the provider confirming the California address at which the care was provided. The example in subsection (f)(3) provides that such a statement may be sufficient evidence under subsection (c) to establish the physical location at which the care was provided, as required by subsection (b)(4).
- The example in subsection (f)(4) illustrates a scenario in which the qualifying person's care was provided at a location that the care provider, an individual residing outside of California, rents in California. The taxpayer submitted a notarized statement, signed under penalty of perjury, from the provider confirming the California address at which the care was provided. The example in subsection (f)(4) provides that such a statement may be sufficient evidence under subsection (c) to establish the physical location at which the care was provided, as required by subsection (b)(4).
- The example in subsection (f)(5) illustrates a scenario in which the qualifying person's care is provided by an organization. The taxpayer submitted a copy of the year-end statement from the care provider which is printed on the organization's letterhead. The example in subsection (f)(5) provides that the organization's letterhead may be sufficient evidence under subsection (c) to establish the physical location at which the care was provided, as required by subsection (b)(4).

Subsection (g)(1) provides that this regulation shall apply to records required to be maintained for taxable years beginning on or after January 1, 2013. Subsection (g)(2) provides that this regulation shall also apply when a taxpayer elects to submit the documentation required by this regulation for taxable years beginning prior to January 1, 2013.

## **DISCLOSURES REGARDING THE PROPOSED REGULATORY ACTION**

### Mandate on Local Agencies and School Districts

The Board is not aware of any mandate on local agencies or school districts that would be created by reasonable compliance with the proposed regulation.

### Cost or Savings to State Agencies, Local Agencies or School Districts, and Federal Funding

The adoption of proposed Regulation section 17052.6 will not have any fiscal impact on state government.

The Board is not aware of any cost or savings to any state agency, any cost to any local agency or school district that is required to be reimbursed under Part 7 (commencing with Section 17500) of Division 4 of Title 2 of the California Government Code, other nondiscretionary cost or savings imposed on local agencies, and the cost or savings in federal funding to the state, that will result from the adoption of the proposed regulation.

### Economic Impact on Business and the Ability of California Businesses to Compete

Since the proposed regulation will clarify the substantiation requirements for taxpayers, and compliance with the proposed regulation will require no more than 15 minutes of clerical time (per child/dependent) on the part of the care provider, the Franchise Tax Board has determined that there will be no adverse economic impact on business, including the ability of California businesses to compete with businesses in other states.

### Potential Cost Impact on Directly Affected Private Persons or Businesses

Since the proposed regulation only affects the documentation required to be supplied from existing care providers and taxpayers, the Board has made an initial determination that the adoption of the proposed regulation will not result in costs incurred by private persons or businesses for reasonable compliance with the proposed action. It is anticipated that the additional clerical time on the part of the care provider to supply identity documentation and proof of payment documentation as required under this proposed regulation will not exceed 15 minutes per child or dependent.

### Effect on Jobs and Business in California

The Board is required to assess any impact the regulations may have on the creation or elimination of jobs in the State of California, the creation of new businesses, the elimination of existing businesses, and the expansion of businesses currently operating in the state.

Since the proposed regulation only affects the documentation required to be supplied from existing care providers and taxpayers, the adoption of the proposed Regulation section 17052.6 would not have any impact on the number of jobs or businesses

created or eliminated, or on the expansion of business currently doing business within the state.

### Impact on Small Business

Since the proposed regulation only affects the documentation required to be supplied from existing care providers and taxpayers, the Board has made an initial determination that the adoption of the proposed regulation will not affect small businesses. It is anticipated that the additional clerical time on the part of the care provider to supply identity documentation and proof of payment documentation as required under this proposed regulation will not exceed 15 minutes per child or dependent.

### Impact on Housing Costs

The Board is not aware of any significant effect on housing costs that will be incurred by reasonable compliance with the proposed regulation.

## **RESULTS OF THE ECONOMIC IMPACT ANALYSIS**

Pursuant to Government Code section 11346.3, subdivision (b), the Franchise Tax Board has determined in the economic impact analysis that since compliance with the regulation will require no more than 15 minutes of clerical time (per child/dependent) on the part of the care provider, there are no effects on the creation or elimination of jobs in the state and no effect on the creation of new businesses or elimination or expansion of existing businesses within the state. The proposed regulation will benefit taxpayers by providing direction as to the documentation that the taxpayer should obtain and retain to establish entitlement to the CDC Credit. In addition, the Franchise Tax Board will save resources by receiving adequate documentation as specified in this regulation rather than having to do an ad hoc analysis based on other possible evidence.

Benefits of the regulation to the health and welfare of California residents, worker safety, and the state's environment: None.

## **CONSIDERATION OF ALTERNATIVES**

In accordance with Government Code section 11346.5, subdivision (a)(13), the Franchise Tax Board must determine that no reasonable alternative considered by the Board or that has otherwise been identified and brought to its attention would be more effective in carrying out the purpose of the proposed regulation or would be as effective and less burdensome to affected private persons than the proposed regulatory action, or would be more cost-effective to affected private persons and equally effective in implementing the statutory policy or other provision of law.

## **AVAILABILITY OF STATEMENT OF REASONS AND TEXT OF PROPOSED REGULATIONS**

An initial statement of reasons has been prepared setting forth the facts upon which the proposed regulatory action is based. The statement includes the specific purpose of the

proposed regulatory action and the factual basis for determining that the proposed regulatory action is necessary.

The express terms of the proposed text of the regulation, the initial statement of reasons and the rulemaking file are prepared and available upon request from the agency contact person named in this notice. When the final statement of reasons is available, it can be obtained by contacting the agency officer named below, or by accessing the Franchise Tax Board's website at [www.ftb.ca.gov/](http://www.ftb.ca.gov/).

## **CHANGE OR MODIFICATION OF ACTIONS**

The proposed regulatory action may be adopted after consideration of any comments received during the comment period.

The regulation may also be adopted with modifications if the changes are nonsubstantial or the resulting regulation is sufficiently related to the text made available to the public so that the public was adequately placed on notice that the regulation as modified could result from that originally proposed. The text of the regulation as modified will be made available to the public at least 15 days prior to the date on which the regulation is adopted. Requests for copies of any modified regulation should be sent to the attention of the agency officer named below.

## **ADDITIONAL COMMENTS**

If you plan on attending or making an oral presentation at the regulation hearing, please contact the agency officer named below.

The hearing room is accessible to persons with physical disabilities. Any person planning to attend the hearing who is in need of a language interpreter or sign language assistance should contact the officer named below at least two weeks prior to the hearing so that the services of an interpreter may be arranged.

## **CONTACT**

All inquiries concerning this notice or the hearing should be directed to Colleen Berwick at Franchise Tax Board, Legal Division, P.O. Box 1720, Rancho Cordova, CA 95741-1720; Telephone (916) 845-3306; Fax (916) 845-3648; E-Mail: [Colleen.Berwick@ftb.ca.gov](mailto:Colleen.Berwick@ftb.ca.gov). In addition, all questions on the substance of the proposed regulation can be directed to Jaclyn Appleby; Telephone (916) 845-5712; E-Mail: [Jaclyn.Appleby@ftb.ca.gov](mailto:Jaclyn.Appleby@ftb.ca.gov). This notice, the initial statement of reasons and express terms of the proposed regulation are also available at the Franchise Tax Board's website at [www.ftb.ca.gov](http://www.ftb.ca.gov).