



Analysis of Original Bill

Author: Caballero & Rubio	Sponsor: None	Bill Number: AB 2023
Analyst: Davi Milam	Phone: (916) 845-2551	Introduced: February 5, 2018
Attorney: Bruce Langston	Related Bills: See Legislative History	

Subject: Child & Dependent Care Expenses Credit/ Refundable

Summary

This bill, under the Personal Income Tax Law (PITL), would make the Child and Dependent Care Expenses Credit refundable.

Recommendation – No position.

Reason for the Bill

The reason for this bill is to minimize the financial strains of childcare for low- to middle-income working families.

Effective/Operative Date

This bill would be effective January 1, 2019, and specifically operative for taxable years beginning on or after January 1, 2019.

Federal Law

Existing federal law allows a tax credit called the Child and Dependent Care Expenses Credit for 20 to 35 percent (depending on the taxpayer's adjusted gross income (AGI)) of employment-related costs of care for a qualifying individual. 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 Child and Dependent Care Expenses Credit similar to the federal Child and Dependent Care Expenses Credit. 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 from 34 to 50 percent based on the taxpayer's AGI,¹ and is limited to taxpayers with AGI of \$100,000 or less.

This Bill

For taxable years beginning on or after January 1, 2019, this bill, under the PITL, would provide that if the amount of allowable Child and Dependent Care Expenses Credit exceeds the tax liability for the taxable year, the excess would be credited against other amounts due, if any, and the balance, if any, upon appropriation by the Legislature, would be refunded to the taxpayer.

Implementation Considerations

Implementing this bill would require changes to existing tax forms and instructions, robust education and outreach, and substantial changes to information systems to limit improper payments.

This bill would require regular annual appropriations by the Legislature to pay for the refundable portion of this credit. Disallowance of the credit to some taxpayers could result if the amount of credits claimed exceeds the amount of appropriated funds. This concern could be alleviated by specifying the funds for refund be continuously appropriated from the Tax Relief and Refund Account.

Legislative History

SB 86 (Senate Budget and Fiscal Review Committee, Chapter 14, Statutes of 2011) made the Child and Dependent Care Expenses Credit nonrefundable for taxable years beginning on or after January 1, 2011.

Program Background

Legislative Analyst Office (LAO) Report

On April 7, 2016, the LAO issued a report titled, "Options for Modifying the State Child Care Tax Credit." This report discussed the option of restoring refundability to the State's Child Care Tax Credit (referred to as "Option 1"). The report also discussed the potential for improper claims, including administrative methods to limit these claims.²

¹ Revenue & Taxation Code 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.

² [LAO Report - Options for Modifying the State Child Care Tax Credit](#).

Other States' Information

The states surveyed include *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.

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

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

Fiscal Impact

The department's costs to implement this bill have yet to be determined, but are anticipated to be significant. 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 bill would result in the following revenue loss:

Estimated Revenue Impact of AB 2023, as Introduced on February 5, 2018
For Taxable Years Beginning On or After January 1, 2019
Assumed Enactment after June 30, 2018 (\$ in Millions)

Fiscal Year	Revenue ³
2018-2019	- \$47.0
2019-2020	- \$80.0
2020-2021	- \$80.0

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

³ This estimate assumes appropriation by the Legislature.

Revenue Discussion

Using Child and Dependent Care Expenses Credit data from the Internal Revenue Service (IRS) and data from the Franchise Tax Board (FTB), California taxpayers reported approximately \$400 million in federal Child and Dependent Care Expenses Credit in 2015.

After applying the California percentages allowable of the federal credit, the estimated California Child and Dependent Care Expenses Credit allowable would be \$85 million. Under current law, the amount of credit each taxpayer could use is limited by their tax liability. These taxpayers currently claim an estimated \$33 million in Child and Dependent Care Expenses Credit per year. However, this bill would, upon appropriation by the Legislature, allow a refund of the credit in excess of the taxpayer's tax liability. The estimated amount of credit claimed is then increased by 30 percent, to \$110 million, to account for additional qualifying taxpayers that would file returns to claim the refundable credit. This amount is then reduced by the amount of credit currently claimed. As a result, the estimated revenue loss from the refundable credit is an estimated \$75 million for 2015. The estimate is then adjusted to reflect changes in the economy over time, resulting in an estimated \$80 million revenue loss in 2019.

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

Support/Opposition

Support: California Child Care Resource & Referral Network and Children's Defense Fund-California.

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 child care, the possibility of refunds would make child care more affordable to these families.

Opponents: Some may argue that there are more effective ways to assist taxpayers with child care costs than providing a refundable tax credit that may be prone to improper claims.

Policy Concerns

The department is concerned that another refundable credit could increase the trend in refund fraud and identity theft. Historically, both the IRS and the FTB have experienced fraud and improper claims with refundable credits. These concerns are heightened because if a refund is determined to be fraudulent; the refund commonly cannot be recovered.

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

Legislative Staff Contact

Davi Milam
Legislative Analyst, FTB
(916) 845-2551
davi.milam@ftb.ca.gov

Jame Eiserman
Revenue Manager, FTB
(916) 845-7484
jame.eiserman@ftb.ca.gov

Diane Deatherage
Legislative Director, FTB
(916) 845-6333
diane.deatherage@ftb.ca.gov