



Bill Analysis

Author: Choi	Sponsor:	Bill Number: AB 2496
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Attorney: Shane Hofeling	Related Bills: See Legislative History	

Subject

Employer-Provided Child Care Credit

Summary

This bill would allow a tax credit for qualified child care expenses and qualified child care resource and referral expenses incurred by employers for employee child care.

Recommendation

No position

Summary of Amendments

None.

Reason for the Bill

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

ANALYSIS

Under the Personal Income Tax Law (PITL) and the Corporation Tax Law (CTL), for each taxable year beginning on or after January 1, 2020, and before January 1, 2025, this bill would provide modified conformity to the federal employer-provided child care credit that allows a credit in the amount of:

- 25 percent of the qualified child care expenses, and
- 10 percent of the qualified child care resource and referral expenses.

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The bill would modify the federal definition of qualified child care expenses to include amounts paid or incurred for any of the following:

1. To acquire, construct, rehabilitate, or expand property which is to be used as part of a qualified child care facility of the taxpayer that is located in California,
2. Operating costs of a qualified child care facility of the taxpayer that is located in California, and
3. Under a contract with a qualified child care facility to provide child care services within California to employees of the taxpayer who are paid less than \$36,000 in gross wages by the taxpayer in the taxable year.

The bill would also, in modified conformity with the federal employer-provided child care credit, provide for recapture of any credit allowed under the provisions of this bill if there is a recapture event, as defined under federal law, with respect to any qualified child care facility of the taxpayer. Such recapture amount would be added to the basis of the property if such basis was reduced under the provisions of this bill.

The bill would make the federal credit carryover provisions inapplicable, and instead allow any unused credit to be carried forward for two taxable years. Carryback of the credit would not be allowed. Any increase in tax due to recapture would not be treated as a tax imposed for purposes of determining the amount of credits allowed under the PITL and CTL or for application of the alternative minimum tax (AMT).

Revenue and Taxation Code (R&TC) Section 41 Requirements

The specified goals, purposes, and objectives of the credit as required by R&TC section 41, would be:

- To incentive companies and employers to provide onsite or cheaper contracted child care for their employees in order to help working families continue to work and not exit the workforce in the situation of a newborn.
- To test whether through incentives, companies can lessen the burden on working families needing child care and thus save the state money in its child care crisis and keep workforce levels and income stable.

To measure whether the credit meets those specified goals, purposes, and objectives the Franchise Tax Board (FTB) would be required to prepare a written report on the use of the tax credit within California for each fiscal year in which the credit allowed is taken on a tax return, and to identify any increases or decreases in credit amounts allowed from year to year or lack of use.

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The report would include the following data:

- Number of taxpayers that were allowed the credit,
- Total amount of tax credits that were allowed and taken on a tax return during the fiscal year, and
- A breakdown on whether the credit taken was for:
 - Qualified child care expenditures for acquiring, constructing, rehabilitating or expanding property to be used as part of a qualified child care facility of the taxpayer,
 - For operating costs of a qualified child care facility of the taxpayer, or
 - For a contract with a qualified child care facility to provide child care services.

FTB would be required to submit the written report to the Legislature annually commencing with the 2020–2201 fiscal year until the 2025–2026 fiscal year, and in compliance with Section 9795 of the Government Code.

Effective/Operative Date

As a tax levy, this bill would be effective immediately upon enactment, and would be specifically operative for taxable years beginning on or after January 1, 2020, and before January 1, 2025.

Federal Law/State Law

Federal Law

Under federal law, taxpayers receive an employer-provided child care credit 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. In addition, a depreciation deduction, or amortization in lieu of depreciation, must be allowable with respect to the property and the property must not be part of the principal residence of the taxpayer or any employee of the taxpayer,
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.

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To be a qualified child care facility, the principal use of the facility must be for child care (unless it is the principal residence of the taxpayer), and the facility must meet all applicable State and local laws and regulations, including any licensing laws. A facility is not treated as a qualified child care facility with respect to a taxpayer unless:

1. It has open enrollment to the employees of the taxpayer during the taxable year,
2. Use of the facility (or eligibility to use such facility) does not discriminate in favor of highly compensated employees of the taxpayer (within the meaning of Internal Revenue Code (IRC) section 414(q), and
3. At least 30 percent of the children enrolled in the center are dependents of the taxpayer's employees, if the facility is at the principal trade or business 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. Qualified child care services and qualified child care resource and referral expenditures must be provided (or be eligible for use) in a way that does not discriminate in favor of highly compensated employees of the taxpayer (within the meaning of IRC section 414(q)).

Any amounts for which the taxpayer may otherwise claim a tax deduction are reduced by the amount of these credits. Similarly, if the credits are taken for expenses of acquiring, constructing, rehabilitating, or expanding a facility, the taxpayer's basis in the facility is reduced by the amount of the credits.

Credits taken for the expenses of acquiring, constructing, rehabilitating, or expanding a qualified facility are subject to recapture for the first ten years after the qualified child care facility is placed in service. The amount of recapture is reduced as a percentage of the applicable credit over the ten-year recapture period. Recapture takes effect if the taxpayer either ceases operation of the qualified child care facility or transfers its interest in the qualified child care facility without securing an agreement to assume recapture liability for the transferee.

The recapture amount is not treated as a tax for purposes of determining the amounts of other credits or for application of the AMT.

The employer-provided child care credit is a general business credit. A general business credit consists of various business tax credits,¹ and to the extent it exceeds the relevant tax liability for the taxable year, it is carried back one year (but, in the case of

¹ IRC section 38.

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a new credit, not to a taxable year before that credit is first allowable) and carried forward 20 years.²

State Law

No current provision comparable to federal law.

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 bill would restrict qualified child care expenditure amounts available for the credit, under a contract with a qualified child care facility to provide child care services, to employees of the taxpayer who are paid less than \$36,000 in gross wages by the taxpayer in the taxable year. If it is the author's intent to restrict all other qualified child care expenditures and qualified child care resource and referral expenditures available for the credit to such employees, the bill should be amended.

This bill uses term "gross wages" that is undefined. The absence of definitions to clarify this term could lead to disputes with taxpayers and would complicate the administration of this bill. The author may want to amend the bill to clearly define this term.

The bill requires the FTB to annually provide a written report on the use of the employer-provided child care income tax credit in California for each fiscal year, but lacks a specification of the due date of the annual report. For clarity and ease of administration, it is recommended that the bill be amended. Additionally, the required breakdown of the annual expenditure amounts used in the credit calculation would necessitate the development of a new departmental form or worksheet, with related processing and system updates.

Technical Considerations

The language that would add a reference to federal Public Law 107-147 is unnecessary because existing state law would incorporate changes made by that public law.³

² IRC section 39.

³ Public Law 107-147 was effective before the specified date of January 1, 2015. See R&TC sections 17024.5 and 23051.5.

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For consistency with similar provisions of the R&TC and this bill, add “of the Internal Revenue Code” after “Section” in each place where the bill refers to an IRC section and such reference is missing.

For consistency with similar provisions of the bill, a reference to IRC section 38 should be eliminated by inserting a new paragraph (1) in subdivision (a) of sections 17053.4 and 23606.

For consistency with other similar provisions of the R&TC, IRC section 45F(e) relating to aggregation, pass-thru, and allocation in the case of partnerships, that is conformed to in subdivision (c) of sections 17053.4 and 23606, should be modified to eliminate references to IRC section 52, and to use standalone language.

See the attached proposed amendments.

Policy Concerns

This bill provides a state credit in an amount equal to a federal credit for employment-related expenses. In general, a taxpayer's federal income tax liability is significantly higher than his or her state income tax liability. As a result, a state tax credit equal in amount to a federal credit could be considered to provide a greater proportionate benefit for state tax purposes than for federal tax purposes.

Legislative History

SB 670 (Jackson & Nguyen, 2013/2014), would have extended the sunset date of the Employer Child Care Credit and the Contributions Credit to January 1, 2021, SB 670 failed to pass out of the Senate Appropriations Committee.

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.

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.

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Program Background

None noted.

Fiscal Impact

The department's costs to implement these provisions 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 bill would result in the following revenue loss:

Estimated Revenue Impact of AB 2496 as Introduced on February 19, 2020
Assumed Enactment after June 30, 2020

(\$ in Millions)

Fiscal Year	Revenue
2020-2021	-\$1.8
2021-2022	-\$2.1
2022-2023	-\$2.4

This analysis does not account for changes in employment, personal income, or gross state product that could result from this bill or for the net final payment method of accrual.

Revenue Discussion

Based on data from the Internal Revenue Service and FTB, it is estimated \$5 million of credit would be earned by qualified taxpayers in the 2020 taxable year. This amount is then reduced by 20 percent, to \$4 million, to account for the employees' gross wage limitation for qualified childcare resource and referral expenditures paid or incurred, as specified in the bill.

Using data from FTB, it is estimated that 75 percent, or \$3 million, of credit would be earned by taxpayers with enough tax liability to offset the credit, and 35 percent, or \$1 million, would be used in the year generated. The remaining credit would be used over the subsequent two years.

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To arrive at the offsetting tax effect of qualified expenditures that would otherwise be allowed under current law, it is estimated that taxpayer's would no longer be able to deduct approximately \$1 million in childcare facility and referral expenditures. Multiplying an average tax rate of 6 percent, results in an estimated offsetting revenue gain of \$60,000 in the 2020 tax year. Combining the two results in an estimated net revenue loss of \$930,000 in the 2020 tax year. This includes an adjustment for credit recapture.

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

Legal Impact

None noted.

Appointments

None noted.

Support/Opposition

To be determined.

Arguments

To be determined.

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Proposed Amendments

Amendment 1

On page 2, on line 1, insert:

SECTION 1. Section 17053.4 is added to the Revenue and Taxation Code, to read:

17053.4. (a) For each taxable year beginning on or after January 1, 2020, and before January 1, 2025, there shall be allowed as a credit against the "net tax" (as defined by Section 17039) an amount determined in accordance with subsections (a), (b), and (c) of Section 45F of the Internal Revenue Code, relating to employer-provided child care credit, ~~as amended by Public Law 107-147~~, except as follows:

(1) Section 45F(a) of the Internal Revenue Code is modified by deleting "For purposes of section 38, the" and inserting in lieu thereof the word "The".

(~~2~~) Section 45F(c)(1)(A)(iii) of the Internal Revenue Code is modified by deleting "employees of the taxpayer" and inserting in lieu thereof the following: "employees of the taxpayer who are paid less than thirty-six thousand dollars (\$36,000) in gross wages by the taxpayer in the taxable year."

(~~3~~) Any reference to "qualified child care facility" shall only mean a qualified childcare facility located in California.

(~~4~~) Any reference to "child care resource and referral services" shall only mean services provided in California.

(b) Section 45F(d) of the Internal Revenue Code, relating to recapture of acquisition and construction credit, shall apply for purposes of a credit allowed by this section, except as follows:

(1) Section 45F(d)(1) is modified by deleting "~~under this chapter~~" and inserting in lieu thereof "this part."

Amendment 2

On page 3, on line 1, insert:

(2) Section 45F(d)(1)(B) of the Internal Revenue Code is modified by deleting "Section 38" and inserting in lieu thereof "subdivision (a)."

(3) The reference to "this section" in Section 45F(d)(4)(A) of the Internal Revenue Code shall mean this section of the Revenue and Taxation Code.

(4) Section 45F(d)(4)(A) of the Internal Revenue Code is modified to delete "carryforwards and carrybacks under Section 39" and inserting in lieu thereof "the carryover amount allowed in subdivision (e)."

(5) Section 45F(d)(4)(B) of the Internal Revenue Code shall not apply and instead the following shall apply: "Any increase in tax due to the application of Section 45F(d)(1) of the Internal Revenue Code by this subdivision shall not be treated as a tax imposed by this part for purposes of determining the amount of any credit allowed under this part or for purposes of Chapter 2.1 (commencing with Section 23400)."

(6) Section 45F(d)(4)(C) of the Internal Revenue Code is modified by deleting "under this subsection" and inserting in lieu thereof "due to the application of Section 45F(d)(1) of the Internal Revenue Code by this subdivision."

(c) Section 45F(e), relating to special rules, shall apply for purposes of a credit allowed by this section, except as otherwise provided.

(1) Subsections (a) and (b) of Section 52 of the Internal Revenue Code shall not apply, and in lieu thereof, the following shall apply:

(A) For purposes of this section:

(i) All taxpayers that are treated as related under Section 267, 318, or 707 of the Internal Revenue Code shall be treated as employed by a single qualified taxpayer.

(ii) All taxpayers of all corporations that are members of the same controlled group of corporations shall be treated as employed by a single taxpayer.

(iii) The credit, if any, allowable by this section to each member shall be determined by reference to its proportionate share of the expense of the qualified expenses giving rise to the credit, and shall be allocated in that manner.

(B) For purposes of this subdivision, "controlled group of corporations" means a controlled group of corporations as defined in Section 1563(a) of the Internal Revenue Code, except that:

(i) "More than 50 percent" shall be substituted for "at least 80 percent" each place it appears in Section 1563(a)(1) of the Internal Revenue Code.

(ii) The determination shall be made without regard to subsections (a)(4) and (e)(3)(C) of Section 1563 of the Internal Revenue Code.

(C) Rules similar to the rules provided in Sections 46(e) and 46(h) of the

Internal Revenue Code, as in effect on November 4, 1990, shall apply to both of the following:

(i) An organization to which Section 593 of the Internal Revenue Code applies.

(ii) A regulated investment company or a real estate investment trust subject to taxation under this part.

(2) For purposes of Section 45F(e)(2) of the Internal Revenue Code, relating to pass-thru in the case of estates and trusts, Section 52(d)(2) of the Internal Revenue Code, is modified to delete "subject to section 38(c)," and "under section 38(a)".

(d) Section 45F(f) of the Internal Revenue Code, relating to no double benefit, shall apply for purposes of this part with respect to a credit allowed by this section, except as follows:

(1) Section 45F(f)(1)(B) of the Internal Revenue Code, relating to certain dispositions, shall not apply and instead the following shall apply:

(A) If, during any taxable year, there is a recapture amount determined with respect to any property the basis of which was reduced due to the application of Section 45F(f) of the Internal Revenue Code by this subdivision, the basis of the property (immediately before the event resulting in the recapture) shall be increased by an amount equal to the recapture amount.

(B) For purposes of this section, "recapture amount" means any increase in tax determined by application of Section 45F(d) of the Internal Revenue Code by subdivision (b) or adjustment in the carryover amount allowed by subdivision (e).

(2) The reference to "this section" in Section 45F(f)(1)(A) of the Internal Revenue Code shall mean this section of the Revenue and Taxation Code.

(3) Section 45F(f)(2) of the Internal Revenue Code is modified by deleting "this chapter with respect to the amount of the credit determined under this section" and inserting in lieu thereof "this part with respect to the amount of the credit determined under this section."

Amendment 3

On page 4, on line 5, insert:

SECTION 1. Section 23606 is added to the Revenue and Taxation Code, to read:

23606. (a) For each taxable year beginning on or after January 1, 2020, and before January 1, 2025, there shall be allowed as a credit against the "tax" (as defined by Section 23036) an amount determined in accordance with subsections (a), (b), and (c) of Section 45F of the Internal Revenue Code, relating to employer-provided child care credit, ~~as amended by Public Law 107-147~~, except as follows:

(1) Section 45F(a) of the Internal Revenue Code is modified by deleting "For purposes of section 38, the" and inserting in lieu thereof the word "The".

~~(2)~~ Section 45F(c)(1)(A)(iii) of the Internal Revenue Code is modified by deleting "employees of the taxpayer" and inserting in lieu thereof the following: "employees of the taxpayer who are paid less than thirty-six thousand dollars (\$36,000) in gross wages by the taxpayer in the taxable year."

~~(23)~~ Any reference to "qualified child care facility" shall only mean a qualified childcare facility located in California.

~~(34)~~ Any reference to "child care resource and referral services" shall only mean services provided in California.

(b) Section 45F(d) of the Internal Revenue Code, relating to recapture of acquisition and construction credit, shall apply for purposes of a credit allowed by this section, except as follows:

(1) Section 45F(d)(1) is modified by deleting "~~under this~~ chapter" and inserting in lieu thereof "this part."

(2) Section 45F(d)(1)(B) of the Internal Revenue Code is modified by deleting "Section 38" and inserting in lieu thereof "subdivision (a)."

(3) The reference to "this section" in Section 45F(d)(4)(A) of the Internal Revenue Code shall mean this section of the Revenue and Taxation Code.

(4) Section 45F(d)(4)(A) of the Internal Revenue Code is modified to delete "carryforwards and carrybacks under Section 39" and inserting in lieu thereof "the carryover amount allowed in subdivision (e)."

(5) Section 45F(d)(4)(B) of the Internal Revenue Code shall not apply and instead the following shall apply: "Any increase in tax due to the application of Section 45F(d)(1) of the Internal Revenue Code by this subdivision shall not be treated as a tax imposed by this part for purposes of determining the amount of any credit allowed under this part or for purposes of Chapter 2.1 (commencing with Section 17062)."

Amendment 4

On page 5, on line 1, insert:

(6) Section 45F(d)(4)(C) of the Internal Revenue Code is modified by deleting “under this subsection” and inserting in lieu thereof “due to the application of Section 45F(d)(1) of the Internal Revenue Code by this subdivision.”

(c) Section 45F(e), relating to special rules, shall apply for purposes of a credit allowed by this section, except as otherwise provided.

(1) Subsections (a) and (b) of Section 52 of the Internal Revenue Code shall not apply, and in lieu thereof, the following shall apply:

(A) For purposes of this section:

(i) All taxpayers that are treated as related under Section 267, 318, or 707 of the Internal Revenue Code shall be treated as employed by a single qualified taxpayer.

(ii) All taxpayers of all corporations that are members of the same controlled group of corporations shall be treated as employed by a single taxpayer.

(iii) The credit, if any, allowable by this section to each member shall be determined by reference to its proportionate share of the expense of the qualified expenses giving rise to the credit, and shall be allocated in that manner.

(B) For purposes of this subdivision, “controlled group of corporations” means a controlled group of corporations as defined in Section 1563(a) of the Internal Revenue Code, except that:

(i) “More than 50 percent” shall be substituted for “at least 80 percent” each place it appears in Section 1563(a)(1) of the Internal Revenue Code.

(ii) The determination shall be made without regard to subsections (a)(4) and (e)(3)(C) of Section 1563 of the Internal Revenue Code.

(C) Rules similar to the rules provided in Sections 46(e) and 46(h) of the Internal Revenue Code, as in effect on November 4, 1990, shall apply to both of the following:

(i) An organization to which Section 593 of the Internal Revenue Code applies.

(ii) A regulated investment company or a real estate investment trust subject to taxation under this part.

(2) For purposes of Section 45F(e)(2) of the Internal Revenue Code, relating to pass-thru in the case of estates and trusts, Section 52(d)(2) of the Internal Revenue Code, is modified to delete “subject to section 38(c),” and “under section 38(a)”.

(d) Section 45F(f) of the Internal Revenue Code, relating to no double benefit, shall apply for purposes of this part with respect to a credit allowed by this section, except as follows:

(1) Section 45F(f)(1)(B) of the Internal Revenue Code, relating to certain

dispositions, shall not apply and instead the following shall apply:

(A) If, during any taxable year, there is a recapture amount determined with respect to any property the basis of which was reduced due to the application of Section 45F(f) of the Internal Revenue Code by this subdivision, the basis of the property (immediately before the event resulting in the recapture) shall be increased by an amount equal to the recapture amount.

(B) For purposes of this section, "recapture amount" means any increase in tax determined by application of Section 45F(d) of the Internal Revenue Code by subdivision (b) or adjustment in the carryover amount allowed by subdivision (e).

(2) The reference to "this section" in Section 45F(f)(1)(A) of the Internal Revenue Code shall mean this section of the Revenue and Taxation Code.

(3) Section 45F(f)(2) of the Internal Revenue Code is modified by deleting "this chapter with respect to the amount of the credit determined under this section" and inserting in lieu thereof "this part with respect to the amount of the credit determined under this section."