



Analysis of Original Bill

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Sponsor:

Bill Number: SB 26

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Related Bills: See Legislative
History

Subject: Child & Dependent Care Expenses Credit/Refundable

Summary

This bill would, under the Personal Income Tax Law (PITL), make the Child and Dependent Care Expenses Credit refundable, subject to an appropriation in the annual Budget Act.

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, 2020, and specifically operative for taxable years beginning on or after January 1, 2020, and before January 1, 2025.

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 federal 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, 2020, and before January 1, 2025, 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, subject to the limitations below and upon appropriation by the Legislature, would be paid to the taxpayer.

The amount paid to the taxpayer would be \$0 unless otherwise specified in the annual Budget Act or any bill providing appropriations related to the Budget Act.

The amount paid to the taxpayer would be limited to:

- Two hundred fifty dollars (\$250) for one qualifying individual.
- Five hundred dollars (\$500) for two or more qualifying individuals.

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.

Capping the refundable portion of the Child and Dependent Care Expenses Credit rather than the credit itself would add complexity for the taxpayer and the department. Additionally, the bill lacks administrative details related to the annual appropriation that would be required to pay for the refundable portion of the credit. For example:

- It is unclear when the refund and appropriation amounts would be known or whether the appropriation would be sufficient. Refunds in excess of the appropriation would be denied. This concern would be alleviated by providing for a continuous appropriation.
- By setting the refund amount at zero for years without an appropriation, the refund provision could be intermittently operative. Thus, making it unclear how the department would effectively employ staff and resources necessary to administer the refund

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.

provision. This concern could be alleviated by providing that the refund authorized by this section would only be operative for taxable years for which resources are authorized in the annual Budget Act for the Franchise Tax Board (FTB) to oversee and audit refund returns associated with this credit.

For clarity and ease of administration, the bill should be amended.

Technical Considerations

For consistency of terminology, the following changes are recommended:

- On page 3, line 30, the term “paid” should be replaced with “refunded”.
- On page 3, lines 33 and 35, the term “amount paid” should be replaced with “amount refunded”.

Legislative History

AB 2023 (Caballero, 2017/2018), substantially similar to this bill, would have made the Child and Dependent Care Expenses Credit refundable, subject to an appropriation in the annual Budget Act. AB 2023 failed to pass by the constitutional deadline.

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

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.

² <https://lao.ca.gov/Publications/Report/3417>.

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.

Economic Impact

Revenue Estimate

This bill would result in the following revenue loss:

Estimated Revenue Impact of SB 26 as Introduced December 3, 2018
Assumed Enactment after June 30, 2019

(\$ in Millions)

Fiscal Year	Revenue ³
2019-2020	- \$33
2020-2021	- \$56
2021-2022	- \$56

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

Using 2016 FTB Child and Dependent Care Credit data, it is estimated that taxpayers generated approximately \$75 million in Child and Dependent Care Credits. Taxpayers applied \$33 million of the credits against their tax liabilities, leaving \$42 million in nonrefundable credits unused. The amount of refundable credit, the lesser of either \$250 or \$500 as specified in the bill or the amount of credit available, was calculated resulting in estimated tax refunds of \$35 million. The estimated credit refunded is then increased to \$55 million, to account for additional qualifying taxpayers that would file returns to claim the refundable credit. This amount was then adjusted to reflect changes over time, resulting in an estimated revenue loss from the refundable credit of \$56 million in 2020.

³ This estimate assumes the annual Budget Act or any bill providing for appropriations related to the Budget Act would allow for a refundable Child and Dependent Care credit.

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

Policy Concerns

The department is concerned that another refundable credit could increase the trend in refund fraud and identity theft. Historically, both the Internal Revenue Service 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.

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