



Bill Analysis

Author: Valladares

Sponsor:

Bill Number: AB 2803

Related Bills: See Legislative
History

Amended: March 31, 2022
and April 26, 2022

SUBJECT

Dependent Care Tax Credit

SUMMARY

This bill would, under the Personal Income Tax Law (PITL) and the Corporation Tax Law (CTL), allow a credit for contributions for qualified care provided to a qualified dependent. The maximum total credit that may be claimed by a taxpayer or a small employer taxpayer cannot exceed \$250,000.

RECOMMENDATION

No position.

SUMMARY OF AMENDMENTS

The March 31, 2022, amendments removed provisions of the bill relating to the Labor Code and replaced them with provisions generally discussed in this analysis.

The April 26, 2022, amendments defined the new term "backup care benefit provider" and modified the terms "backup care" and "qualified care." These amendments also modified the percentage amount of the cost paid or incurred by a taxpayer or a small employer taxpayer, modified the amount of the credit allowed in any taxable year, and made several technical changes.

This is the department's first analysis of the bill.

REASON FOR THE BILL

The reason for the bill is to incentivize more employers to offer their employees dependent care support services and to provide working families with additional care support to address affordability, access issues, and to help fill dependent care gaps.

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ANALYSIS

For each taxable year beginning on or after January 1, 2023, and before January 1, 2028, this bill would, under the PTL and CTL, allow a credit to the taxpayer or the small employer taxpayer for a percentage of the amount paid or incurred for contributions for qualified care. The amount of the credit allowed would not exceed \$250,000 in any taxable year.

The credit percentage would be:

- 25 percent of the cost paid or incurred by the taxpayer for contributions to qualified care.
- 30 percent of the cost paid or incurred by the small employer taxpayer for contributions to qualified care.

This bill would define the following terms and phrases:

“Small employer taxpayer” as any taxpayer that satisfies both of the following conditions:

- (A) The average number of employees of the taxpayer on business days during the taxable year does not exceed 75.
- (B) The gross receipts of the taxpayer during the taxable year do not exceed twenty-five million dollars (\$25,000,000).

“Employee” includes an individual who is an employee within the meaning of Internal Revenue Code (IRC) section 401(c)(1), relating to self-employed individual treated as employee.

“Qualified care” includes, but is not limited to, onsite service, center-based service, in-home care or home-provider care, or backup care, provided to a qualified dependent.

“Qualified dependent” means any dependent of a qualified employee who is under 14 years of age. The definition also provides that it does not include a dependent of a qualified employee or that employee’s spouse.

“Qualified employee” means any employee of the taxpayer who is performing services for the taxpayer in this state within the meaning of Revenue and Taxation Code (RTC) section 25133, during the period in which the qualified care is performed. RTC section 25133 is a rule for determining when compensation is paid in California for unitary taxpayers.

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“Contributions” include direct payments for qualified care, but would not include amounts contributed pursuant to a salary reduction agreement to provide benefits under a dependent care assistance program.

“Backup care” means care provided to a qualified dependent when a qualified employee’s regular qualified care cannot be utilized. A taxpayer may provide backup care in any of the following ways:

- (A) By contracting with a qualified care provider or a backup care benefit provider and providing direct payments to the qualified care provider or making payments to a backup care benefit provider for backup care services.
- (B) By directly paying or arranging for payment of backup care annually to a qualified care provider or a backup care benefits provider upon receipt of an invoice detailing the number of backup care hours used by a qualified employee.
- (C) By reimbursing a qualified employee directly or through a backup care benefit provider for backup care paid directly by the employee.

“Backup care benefit provider” means a third-party vendor that offers services to provide employees options for locating or arranging for the provision of backup care, either through various backup care benefit providers or through a reimbursement program for care paid directly by the employee.

This bill would provide that:

- The portion of expenses paid or incurred for the taxable year that is equal to the amount of the credit allowed under this provision would be ineligible for deduction.
- The basis of the facility would be reduced by the amount of the credit in the taxable year the credit is allowed.

The taxpayer would be required to provide, in the form and manner prescribed by the FTB, the number of qualified dependents provided qualified care.

Any excess credit could be carried over until exhausted.

This credit would remain in effect only until December 1, 2028, and would be repealed as of that date.

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Section 3 of this bill states that for purposes of complying with RTC section 41, the Franchise Tax Board (FTB) would be required to prepare a written report to the Legislature by an unspecified date on the following information:

- The number and common characteristics of taxpayers claiming the credit.
- The number and common characteristics of small employer taxpayers claiming the credit.
- The average credit amount on taxpayer tax returns claiming the credit.
- The average credit amount on small employer taxpayer tax returns claiming the credit.
- The number of taxpayers claiming the credit in a taxable year that have not claimed the credit for a previous taxable year.
- The number of small employer taxpayers claiming the credit in a taxable year that have not claimed the credit for a previous taxable year.

The report would be required to be submitted in compliance with Section 9795 of the Government Code to the Senate Committee on Budget and Fiscal Review, the Assembly Committee on Budget, the Senate and Assembly Committees on Appropriations, the Senate Committee on Government and Finance, and the Assembly Committee on Revenue and Taxation.

Effective/Operative Date

As a tax levy, this bill would be effective immediately upon enactment and specifically operative for taxable years beginning on or after January 1, 2023, and before January 1, 2028.

Federal/State Law

Federal Law

Federal law allows a tax credit equal to 25 percent of employer-provided qualified child care expenditures and 10 percent of employer-provided qualified child care resource and referral expenditures. The maximum total credit that may be claimed by a taxpayer cannot exceed \$150,000 per taxable year.

Qualified child care expenditures 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, (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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State Law

Existing state law provides various tax credits designed to provide tax relief for taxpayers who incur certain expenses (e.g., child adoption) or to influence behavior, including business practices and decisions (e.g., research credits or economic development area hiring credits). These credits generally are designed to provide incentives for taxpayers to perform various actions or activities that they may not otherwise undertake.

There are currently no state credits comparable to the credit that would be allowed by this bill.

Implementation Considerations

The department has identified the following implementation considerations, and is available to work with the author's office to resolve these and other considerations that may be identified.

This bill uses terms that are undefined, e.g., "business days," "onsite service," "center-based service," "in-home care," "home-provider care," "regular qualified care," and "reimbursement program." For clarity, it is recommended that the bill be amended.

This bill would define "small employee taxpayer" as any taxpayer with gross receipts not exceeding twenty-five million dollars (\$25,000,000) during the taxable year. The FTB does not capture gross receipts by specified amount on state tax returns and would not be able to validate the defined requirement for all taxpayers.

This bill defines "qualified dependent" as any dependent of a qualified employee who is under 14 years of age. For clarity, the author may wish to include "as of the last day of the taxable year" in this definition.

This bill defines "qualified employee" as any employee of the taxpayer who is performing services for the taxpayer in this state within the meaning of RTC 25133, during the period in which the qualified care is performed. This definition does not determine when services are performed in California. For clarity and consistency, it is recommended to define "qualified employee" as any employee who is paid wages subject to California withholding or eligible to elect to pay State Disability Insurance.

This bill requires the FTB to report to the Legislature regarding the use of this credit. The FTB would be required to prepare a written report on common characteristics of taxpayers and small employer taxpayers claiming the credit. The "common characteristics" requirement is unclear. The author may wish to amend the bill to specify that the data should be reported by income range, filing status, county, entity type, etc.

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The bill is silent on the report date requirements. Because income tax returns for calendar year taxpayers may be filed, with extension, until October 15, the department would not have the data for tax year 2023 until approximately June 2025. If the authors would want to include tax year 2027 in the report, it should be due no earlier than June of 2029. For clarity and ease of administration, it is suggested that the bill be amended to specify the timing of the delivery of the report.

Technical Considerations

Sections 17053.84(c)(6) and 23684(c)(6) contain contradictory definitions of "qualified dependent." If the intention is to allow the credit with respect to employees' dependents under age 14, unless the employee is a dependent of another taxpayer, subparagraphs (2) of both sections cited above should change the phrase "...if the dependent qualifies as a dependent..." to "if the qualified employee qualifies as a dependent..."

For clarity, in Sections 17053.84(c)(8)(A) and 23684(c)(8)(A), it is recommended that the phrase "the average number of employees" be replaced with "the number of employees."

Section 17053.84(c)(4) defines "employee" as "an individual who is an employee within the meaning of IRC section 401(c)(1), relating to self-employed individual treated as employee," which is unclear. Consider amending the phrase to "an individual who is an employee within the meaning of RTC section 17020.12" to provide more clarity.

Section 23684(c)(4) defines "employee" as "an individual who is an employee within the meaning of IRC section 401(c)(1), relating to self-employed individual treated as employee," which is unclear. Consider amending the phrase to "an individual who is an employee within the meaning of RTC section 23045.6" to provide more clarity.

Policy Considerations

This bill is silent as to the tax treatment of contributions for a qualified employee that would receive a benefit from the taxpayer or the small employer taxpayer. The contribution would be taxable for a qualified employee. If this is contrary to the author's intent, the bill should be amended.

This bill would provide that the basis of the facility would be reduced by the amount of the credit in the taxable year the credit is allowed. It is unclear how qualified care is related to the basis of the facility.

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This bill does not limit the number of years for the carryover period. The department would be required to retain the carryover on the tax forms indefinitely. Recent credits have been enacted with a carryover period limitation because experience shows credits typically are exhausted within eight years of being earned.

LEGISLATIVE HISTORY

SB 670 (Jackson, 2015/2016) would have increased the state credit percentages for the Child and Dependent Care Expense Credit. In addition, this bill would have allowed credits for employer child care facility start-up expenses and contributions to a qualified child care plan. SB 670 did not pass out the Assembly 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.

AB 866 (Diaz, Chapter 650, Statutes of 2001), 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.

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 did not pass out of the Senate Appropriations Committee.

PROGRAM BACKGROUND

Until December 1, 2011, prior law allowed the Employer Child Care Credit. The FTB was required to report to the Legislature by January 1, 2011, the following information:

The amount of the Employer Child Care Credit claimed each year was approximately \$400,000 and the estimated average number of children served each year was 1,400:

Tax Year	Credit Claimed	Children Served
2007	\$410,000	1,200
2008	\$490,000	1,900
2009	\$410,000	1,100
2010	\$370,000 (partial year)	600 (partial year)

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.

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ECONOMIC IMPACT

Revenue Estimate

This bill would allow a credit, as specified in the bill, to a taxpayer for costs paid for contributions to qualified care made on behalf of any dependent of the taxpayer's California employee who is under the age of 14.

To determine the potential impact to the General Fund the number of taxpayers with employees that have dependents under the age of 14 using qualified care and that do not claim the dependent on their return would need to be known. Because this information is difficult to predict, the revenue impact is unknown.

However, it is expected that for every \$1 million in credits generated in taxable year 2023, approximately \$300,000 of credit would be claimed and used to offset tax. The remaining credit would be used over the subsequent years or until exhausted. It is further estimated approximately \$300,000 in qualified care expenditures would no longer be able to be deducted as expenses on the taxpayer's tax return. Applying an average tax rate of 7 percent, results in an estimated offsetting revenue gain of \$21,000 and a net revenue loss of \$279,000 for the 2023 taxable year.

LEGAL IMPACT

None noted.

APPOINTMENTS

None noted.

SUPPORT/OPPOSITION

To be determined.

ARGUMENTS

To be determined.

LEGISLATIVE CONTACT

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