Appendix D

Tax Credit Committee Policy Questions

When reviewing the tax credit sunset extension bills and proposed new credits, the Joint Committee on Tax Credits intends to address the follow questions:

- What is the public policy purpose of this credit? Is there an expected timeline for achieving this goal?

- Who (groups of individuals, types of organizations or businesses) directly benefits from this credit? Does this credit target a specific group? If so, is it effectively reaching this group?

- What is expected to happen if this credit fully sunsets? Could adequate results be achieved with a scaled down version of the credit? What would be the effect of reducing the credit by 50%?

- What background information on the effectiveness of this type of credit is available from other states?

- Is use of a tax credit an effective and efficient way to achieve this policy goal? What are the administrative and compliance costs associated with this credit? Would a direct appropriation achieve the goal of this credit more efficiently?

- What other incentives (including state or local subsides, federal tax expenditures or subsidies) are available that attempt to achieve a similar policy goal?

- Could this credit be modified to make it more effective and/or efficient? If so, how?

Child Care

Child care is a significant issue for families with young children in which there is only one parent or where both parents work outside the home. Often, child care can be a significant obstacle to parents maintaining full-time employment. As such, the topic receives a considerable amount of attention and resources, both private and public. In recent years, the issue of child care has dovetailed with increased research and greater understanding around the value and potential long-term impact of early childhood education. As the issue has gained prominence, programs such as Head Start have received greater attention.

This section of the report focuses on four tax credits related to the provision of child care. Also discussed are some direct spending programs with similar policy objectives. This is an area where the clarity of purpose for the tax credits is key. The goal of providing a safe environment for young children while parents are at work can easily transform into the larger objective of creating environments that are as stimulating and educational as possible. The potential cost differential between these two priorities can be significant. It would be valuable for the Legislature to provide additional guidance on the policy intent of the tax credits, both individually and collectively. For example, the quality of the child care provided is currently not an explicit parameter of any of the tax credits. Although it would, presumably, be reflected in the price of the child care.

The four tax credits reviewed in this section all support the provision of child care. Two of the tax credits are direct subsidies to the taxpayer for child care expenses. One is a subsidy provided to employers who assist their employees in accessing child care. The last one is a credit for contributions made to Oregon's Office of Child Care, whose mission is "[p]romoting safe, quality, affordable and accessible child care".

Child Care Policy/Program	2013-15 Legislatively Approved Budget ($M)	
	GF	OF
Child Care Funding		
Tax Credit		
Child and Dependent Care	$16.7	
Workiing Family Child Care	$43.2	
Employer Provided Dependent Care Assisatnce	$1.2	
Direct Spending		
Employment Related Daycare	$13.5	$110.1
Early learning programs		
Child Care Regulation		
Tax Credit		
Contributions to the Office of Child Care	$1.0	
Direct Spending		
Child Care Licensing and Quality		

Within the policy context of child care funding, there are several direct and indirect spending programs. The Employment Related Day Care (ERDC) program is a direct spending program that helps low-income families pay for child care. Individuals apply for eligibility to the Department of Human Services (DHS). The amount of the subsidy is determined by the family's income, the type of child care provided, and the number of hours needed. These payments are made directly by DHS to qualified providers. Due to funding limitations, there is a cap on the number of participating families. In fiscal year 2012-13, funding was available for up to 10,000 families. Most of the funding for this program is from the federal government, through the Child Care Development Fund. The program is means tested and phases out at 185 percent of the federal poverty level.

There are also early learning programs that receive direct funding and are, at least tangentially, related to child care. These programs focus on pre-school aged children that incorporate educational and developmental aspects beyond simply supervising care. Examples of such programs include Head Start, Oregon Pre K program, Early Intervention, Early Childhood Special Education, and certain programs with specific target groups such as those for teen parents, migrant workers, and children with special needs.

The first two indirect spending programs are tax credits that consist of a *direct* subsidy to consumers of child care services. The Oregon Child and Dependent Care credit is tied to the federal Child and Dependent Care tax credit. The Working Family Child Care credit is a refundable, Oregon tax credit for child care that is phased out for taxpayers with income above 250 percent of the federal poverty level. These two policies effectively constitute a reduction in the cost of child care. This reduction, however, is likely received in one lump sum at the time the taxpayers' Oregon tax return is filed. The third tax credit is a subsidy for employers who help their employees find appropriate child care services. In this case, the consumers of child care are the *indirect* recipients of the tax credit.

As for the regulation of child care providers, the Early Learning Division within the Department of Education provides licensing for and oversight of many child care providers. The goal of this regulation is to ensure that quality and safety standards are met. The division also provides some information and referral services. The Office of Child Care is located within the Early Learning Division with the purpose of "[p]romoting safe, quality, affordable and accessible child care".

The tax credit for contribution to the Office of Child Care is the one tax credit associated with the regulation of such services. Taxpayers are eligible for a tax credit that is a percentage of their contribution to the office. Recently, such revenue to the office has been used for professional development of providers, presumably leading to improved quality and providing some level of stability to the industry.

Child and Dependent Care

ORS 315.204	Year Enacted:	1975	Transferable:	No
	Length:	1	Means Tested:	Yes
	Refundable:	No	Carryfoward:	5 years
TER 1.421	Kind of cap:	Taxpayer	Inflation Adjusted:	No

Policy Purpose

Bill documentation for the implementing legislation (1975 HB 2008) states that the tax credit is for "employment related expenses", referring to child and dependent care. It was set at eight dollars for every $100 deduction taken on the federal return for such expenses. The structure of the credit was changed in 1977 to a share of the corresponding federal tax credit. According to bill documentation, the changes were in response to substantial changes at the federal level with the Tax Reform Act of 1976.

There were significant changes made in 1989 that appear to constitute a shift from the indirect spending of a tax expenditure to the direct spending of an appropriation, while means testing the tax credit. The structure of the tax credit was changed substantially by making it a percentage of eligible expenses and limiting the tax credit to taxpayers with federal taxable income of no more than $45,000. The revenue gain from these changes was divided up among Adult and Family Services (to provide payments directly to providers), the State Scholarship Commission (to fund day care services for eligible undergraduate students) and the Commission for Child Care (to fund a resources and referral grant program).

Description and Revenue Impact

Taxpayers who claim the federal Child and Dependent Care tax credit are eligible for a similar Oregon credit against personal income taxes. Because the Oregon and federal credits are linked, it is helpful to understand the federal credit. It equals 35 percent of up to $3,000 of qualifying expenses for one child, or $6,000 of qualifying expenses for more than one child. This translates into a maximum federal credit of either $1,050 or $2,100, depending on the number of children. As income exceeds $15,000, the applicable percentage declines. Claimants with incomes over $43,000 qualify for the minimum federal credit of 20 percent of qualifying expenses, either $600 or $1,200.

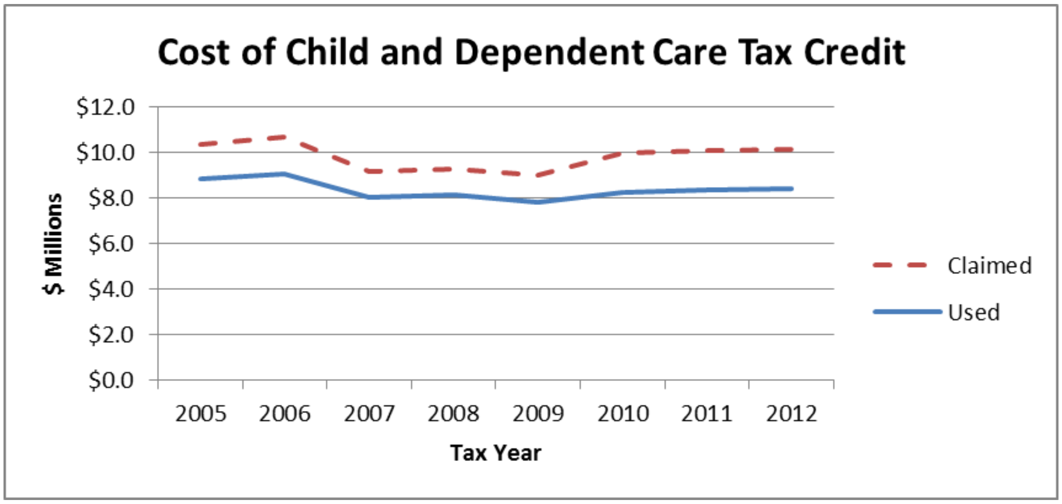
The federal credit is allowed to taxpayers who incur expenses related to the provision of care for at least one qualifying person so that the taxpayer is able to maintain employment. Eligible employment related expenses are those necessary for the taxpayer to be gainfully employed and include expenses for household services and for the care of qualifying dependents. Qualifying dependents are children under 13, other dependents who are physically or mentally incapable of caring for themselves, or the taxpayer's spouse if incapable of caring for himself or herself. The amount of the federal credit is shown in the table below.

Federal AGI is		Share of eligible expenses allowed	Maximum Credit	
Over:	But not over:		One Dependent	At least Two Dependents
$0	$15,000	35%	$1,050	$2,100
$15,000	$17,000	34%	$1,020	$2,040
$17,000	$19,000	33%	$990	$1,980
$19,000	$21,000	32%	$960	$1,920
$21,000	$23,000	31%	$930	$1,860
$23,000	$25,000	30%	$900	$1,800
$25,000	$27,000	29%	$870	$1,740
$27,000	$29,000	28%	$840	$1,680
$29,000	$31,000	27%	$810	$1,620
$31,000	$33,000	26%	$780	$1,560
$33,000	$35,000	25%	$750	$1,500
$35,000	$37,000	24%	$720	$1,440
$37,000	$39,000	23%	$690	$1,380
$39,000	$41,000	22%	$660	$1,320
$41,000	$43,000	21%	$630	$1,260
$43,000	No limit	20%	$600	$1,200

Individuals who qualify for the federal child and dependent care tax credit also qualify for the related Oregon tax credit. The Oregon credit amount is a percentage of eligible expenses based on federal taxable income (see chart below). The dependent care expenses must be employment related and are limited to the lesser of $3,000 for one qualifying dependent and $6,000 for two or more qualifying dependents, or the individual's earned income (or the lower of either spouse's earned income). These limits are reduced by any nontaxable payments received from an employer through a dependent care assistance program. The amount of the Oregon credit is shown in the table below.

Federal taxable income is		Share of eligible expenses allowed	Maximum Credit	
Over:	But not over:		One Dependent	At least Two Dependents
---	$5,000	30%	$900	$1,800
$5,000	$10,000	15%	$450	$900
$10,000	$15,000	8%	$240	$480
$15,000	$25,000	6%	$180	$360
$25,000	$35,000	5%	$150	$300
$35,000	$45,000	4%	$120	$240
$45,000	---	None	$0	$0

The graph below shows relatively consistent use of the tax credit between 2005 and 2012. Use of the credit peaked in 2007 at roughly $10.7 million claimed and $9.1 million used. The amount fell in 2007 through the recession and returned to the roughly $10 million level in 2010. The share used by full-year filers was consistently 95 percent of the total during this time.



Policy Analysis

Because the policy objectives of the four tax credits included in this section are substantially similar, the impact analysis is provided once at the end of this section, following the tax credit for Contributions to the Office of Child Care.

Other Issues

Because this tax credit is based on a federal tax credit, many other states offer a similar credit. The policy levers chosen across the states are summarized here. A detailed table containing specific states is provided in Appendix C.

Key Characteristics

- Percentage of the federal credit
- Percent of eligible expenses
- Refundable or non-refundable
- Hard dollar cap
- Phase-down or phase-out different from the federal policy

Administrative costs are likely to be minimal because the federal policy is leveraged and the state credit is simply a percentage of the federal tax credit.

Working Family Child Care

ORS 315.262	Year Enacted:	1997	Transferable:	No
	Length:	1-year	Means Tested:	Yes
	Refundable:	Yes	Carryfoward:	NA
TER 1.422	Kind of cap:	None	Inflation Adjusted:	NA

Policy Purpose

Bill documentation for the implementing legislation (1997 SB 388) states that the Senate Committee on Revenue was concerned "…for families losing welfare benefits under current federal laws." Testimony provided at the time identified the following three goals: (1) reduce costs for low-income working families; (2) encourage low-wage earners to move from the $6 to $10 per hour wage level; and (3) encourage working families to purchase safe, high-quality child care.

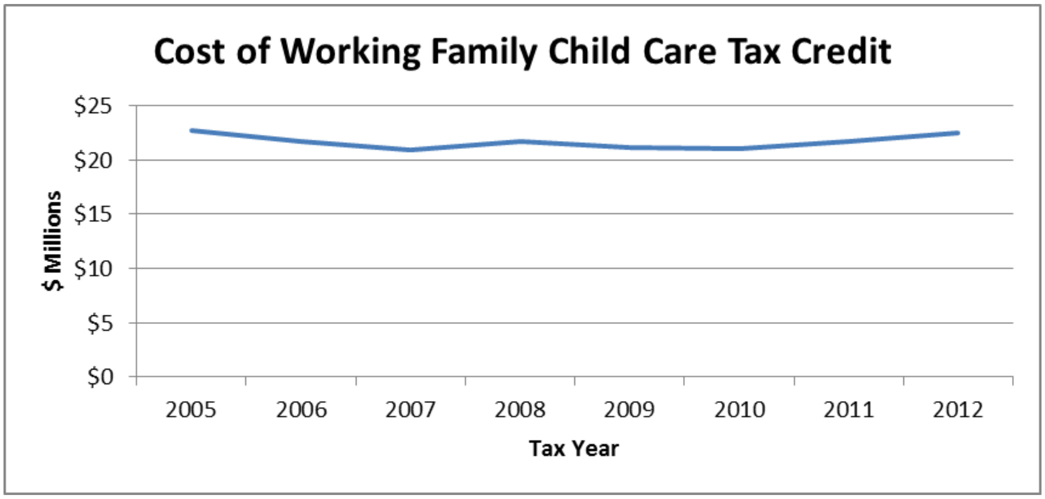
Description and Revenue Impact

Low-income working families are allowed a refundable credit against personal income taxes for qualifying child care expenses. To qualify, taxpayers must have a minimum amount of earned income from Oregon sources. Some limited investment income is allowed. For tax year 2014, the minimum earned income is $8,550 and the maximum amount of investment income is $3,350. The credit is calculated as a percentage of qualified child care expenses. The table below shows how the credit is phased out as income increases above the Federal Poverty Level (FPL), which is based on household size. For example, the 2014 FPL for a household of four is $23,850. So, taxpayers with income of up to $47,700 are eligible for a tax credit equal to 40 percent of their eligible child care expenses. Households of the same size but with income above $59,650 are not eligible for the tax credit.

AGI as a Share of FPL		Share of eligible expenses allowed
Over:	**But not over:**	
---	200%	40%
200%	210%	36%
210%	220%	32%
220%	230%	24%
230%	240%	16%
240%	250%	8%
250%	---	None

Qualifying child care expenses are those necessary for the taxpayer/spouse to be gainfully employed, seeking employment, or attending school part-time or full-time. The care must be for a child under 13, or a child with a disability as defined in ORS 316.099. A qualifying taxpayer may claim both this credit and the child and dependent care credit. Taxpayers may also claim the credit if they need child care because they have a qualifying disabled spouse. To qualify, the spouse's disability must prevent him/her from providing child care, working, seeking employment and attending school.

The use of this tax credit has also been very stable over time, averaging $22 million annually. In fact, since becoming refundable in 2003, the total impact has only varied between $20.9 million and $22.7 million per year. The number of full-year claimants has fallen from its peak of roughly 26,600 in tax years 2004 and 2005 to just above 25,100 in 2011 and 2012. Full-year filers account for 95 percent of the total.



Policy Analysis

See the end of the section (following the tax credit for Contributions to the Office of Child Care) for a complete analysis of this tax credit.

Other Issues

A number of other states have an income tax credit with presumably similar policy objectives. They include: Illinois, Iowa and Maine. Key characteristics of these tax credit and three such states are described here.

Key Characteristics

- Percentage of the eligible expenses
- Income limit
- Interaction with other, similar credits
- Claimant may be employer or employee

The primary administrative issues for this tax credit are incurred by the DOR. Relatively speaking, this credit may cost the DOR more than most tax credits because it is not tied to a similar federal credit or certified by another agency. Due to the inability to rely on other agency's administrative processes, there are special tax forms for the credit and substantial administrative costs to the DOR. Taxpayers incur the usual costs of retaining records in case of a tax audit.

Employer Provided Dependent Care Assistance

ORS 315.204	Year Enacted:	1987	Transferable:	No
	Length:	1	Means Tested:	No
	Refundable:	No	Carryfoward:	5-years
TER 1.423	Kind of cap:	Taxpayer	Inflation Adjusted:	No

Policy Purpose

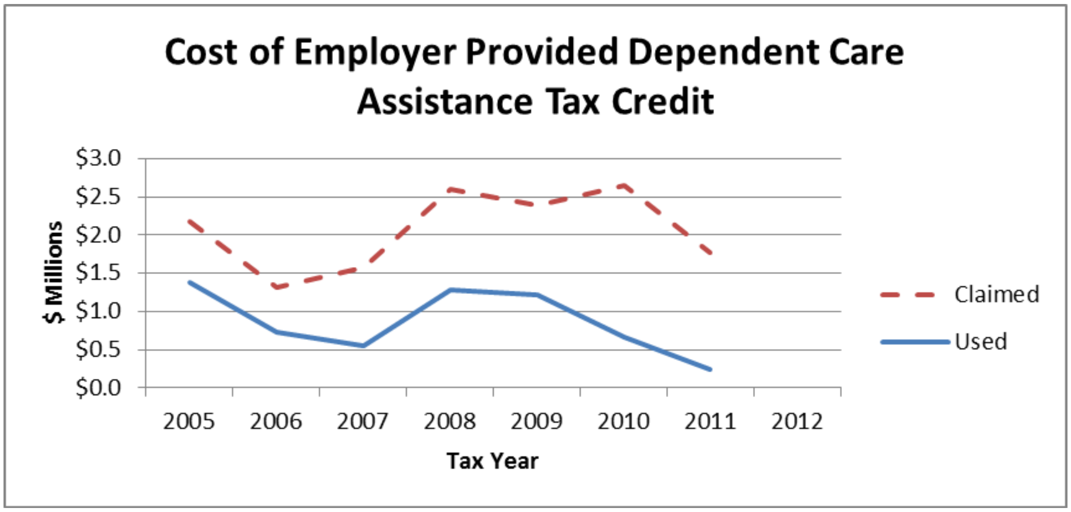
Bill documentation for the implementing legislation (1987 SB 743) states that "[i]ncentives are needed to encourage employers to provide day care assistance to their employees." The staff analysis states that the Senate Labor committee focused on the adequacy of the then-existing tax incentives. Two problems identified at the time were a lack of access to quality, affordable day care for parents with young children, and the limitations of a non-refundable tax credit for low-wage workers. Also cited was the change in federal law that allowed employers to deduct expenses related to the provision of child care. However, that legal change had apparently not led to adequate growth in the supply of child care providers.

There were two aspects to the original tax credit: (1) 50% of the employer's costs to provide dependent care referral services or dependent care assistance payments, up to $2,500 per employee; and (2) employer tax credit for construction or renovation of day care facilities for employees, up to the least of: 50% of cost, $2,500 times the number of employees, or $100,000. The credit was taken uniformly over ten years.

Description and Revenue Impact

Employers providing dependent care assistance or referral services to their employees are allowed a credit against personal or corporate taxes. The credit equals 50 percent of the eligible costs paid, up to $2,500 per employee, and 50 percent of the cost of providing referral services. The employer may not take the credit if the provision of dependent care services is part of a salary reduction plan. Claimants are required to obtain an annual certification by the Office of Child Care.

As shown in the graph below, the use of this tax credit has varied in recent years, while following a general trend downward. It has ranged from $0.2 million in 2011 to $1.4 million in 2005. Its use declined just prior to the economy slipping into recession but bounced back to the one million dollar level as the economy bottomed-out in 2008 and 2009. In the subsequent two years, its use continued to decline. This tax credit is primarily used by corporations, which historically had accounted for roughly 75 percent of all credits used.



Policy Analysis
See the end of the section (following the tax credit for Contributions to the Office of Child Care) for a complete analysis of this tax credit.

Other Issues
Administrative costs include the requirement that employers submit an application for certification to the Office of Child Care in the Department of Education each year they wish to claim the credit.

There appear to be no other states that offer this kind of tax credit.

Contributions to the Office of Child Care

ORS 315.213	Year Enacted:	2001	Transferable:	No
	Length:	1	Means Tested:	No
	Refundable:	No	Carryfoward:	4-years
TER 1.425	Kind of cap:	Program	Inflation Adjusted:	No

Policy Purpose
Bill documentation for the implementing legislation (2001 HB 2676) states that the tax credit is for "…contributions to the Child Care Division[4]…for the purpose of promoting child care…" The implementing bill identified criteria for the Child Care Division to use when identifying eligible child care providers and determining their allocation amounts.

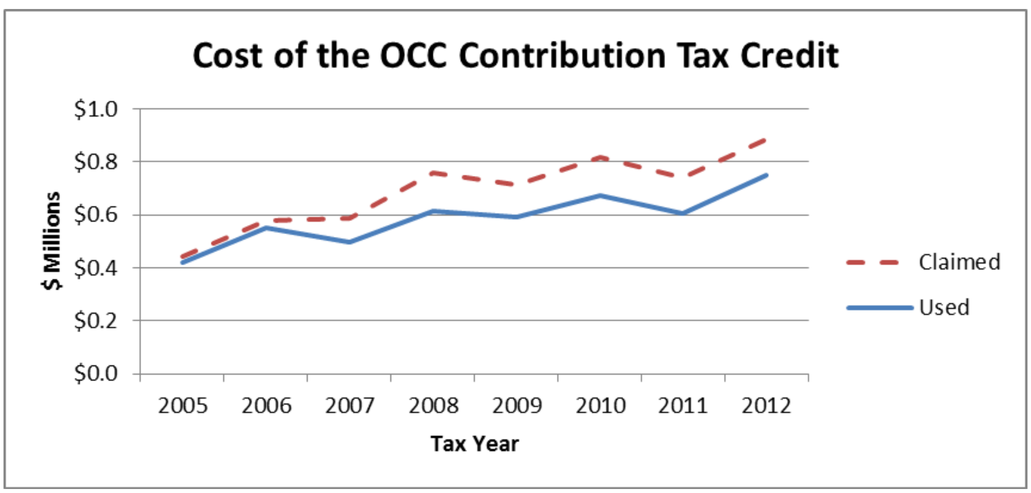
[4] The name was changed to the Office of Child Care by the 2013 Legislature and moved from the Employment Department to the Department of Education.

Discussed at the same time was a proposed corporate child care tax credit modeled after the low-income housing tax credit. Goals cited were to reduce costs to parents, increase provider revenue, and improve quality of care for children of low to moderate income parents.

Description and Revenue Impact

Individuals or businesses that make contributions to the Office of Child Care (OCC) of the Oregon Department of Education are allowed a credit against personal or corporate taxes. The credit is equal to 75 percent of the contribution amount and there is a program cap of $500,000 in tax credits per year. If a charitable contribution deduction is taken at the federal level, only the credit amount needs to be added back to Oregon taxable income. The OCC and selected community agencies distribute the money according to rules established by the Early Learning Council. A selected community agency is a nonprofit agency that provides services related to child care, children and families, community development, or similar services and is eligible to receive tax deductible contributions.

As shown in the chart below, use of this tax credit has gradually grown from $0.4 million in 2005 to just under $0.8 million in 2012. The reason the impact can exceed the annual program cap of $0.5 million is due to carryforwards. Unused tax credits from any one tax year may be carried forward and used in subsequent tax years for up to four years. This trend is reflected in the graph since the difference between the claimed and used amounts has grown over time. In recent years, 98 percent of the revenue impact has been from full-year filers.



Other Issues

The administrative costs of this tax credit are primarily incurred by the OCC as they accept donations and certify tax credits. The DOR and taxpayers have the customary marginal costs of processing, auditing, and record keeping, respectively.

There appear to be no other states that offer a similar tax credit.

Policy Analysis (for all four tax credits)

There is an extensive amount of research that exists on various aspects of child care. The research ranges from the value of early education and how it may affect student performance throughout the school years, to the economic impacts of enabling parents to work. For many years the federal and state governments have offered a variety of subsidies that consist of both direct and indirect spending. Because the purposes of the four tax credits are so closely related, this analysis focuses on the impact of all four tax credit programs collectively.

One key issue that receives much attention is the cost of child care. In fact, the Oregon Secretary of State released a report in December, 2014 that highlights, in part, the difficulties Oregonians have in paying for child care. For context, both the U.S. Department of Health and Human Services and Oregon have adopted an affordability benchmark for child care that is 10 percent of income. A 2013 report by the National Association of Child Care Resources and Referral Agencies found that a married couple paid 19 percent of their income and a single mother paid 62 percent of her income for infant care in 2012.[5] The corresponding figures for care of a four-year-old were 14 percent and 47 percent.

The economic impact of the child care industry can be viewed as having three different components: the longer-term investment effects of the children benefitting from these services, when high quality, learning-centered care is a focus, the employment "enabling" effect for workers utilizing their services, and the direct impact of those businesses providing the service. The discussion here touches on the first two of these topics.

Policies to subsidize the cost of child care have been implemented with a variety of constructs. The broad policy intent has been a combination of two goals: (1) to reduce the cost of employment; and (2) to improve the quality of child care. There has been some research on the role that subsidies play in helping parents choose higher quality child care. Oregon's history, as reflected through the four incentives, provides an example of how policy focus has transformed over the years. The chart below shows the timeline for the adoption of the four tax credits.

1975	1987	1997	2001
Child and Dependent Care	Employer Provided Care	Working Family Child Care	Contributions to the OCC

The original credit was implemented as an offset to employment costs. By the late 1980s, stakeholders remained concerned about access to child care, and an emphasis on the quality of child care had emerged. There was a perceived need to increase access to child care that was

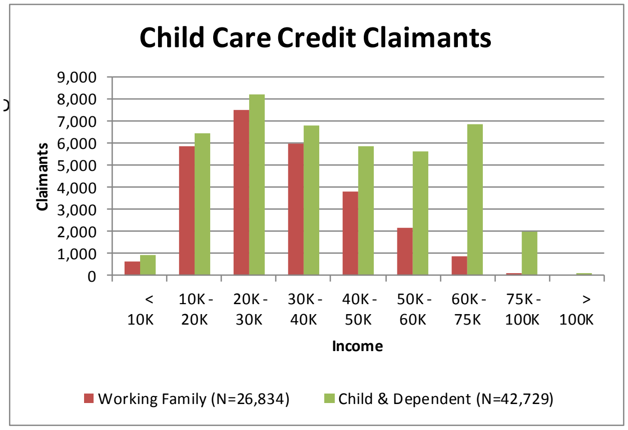
[5] The precise metric used was the average cost of child care in a center divided by the Oregon Median income.

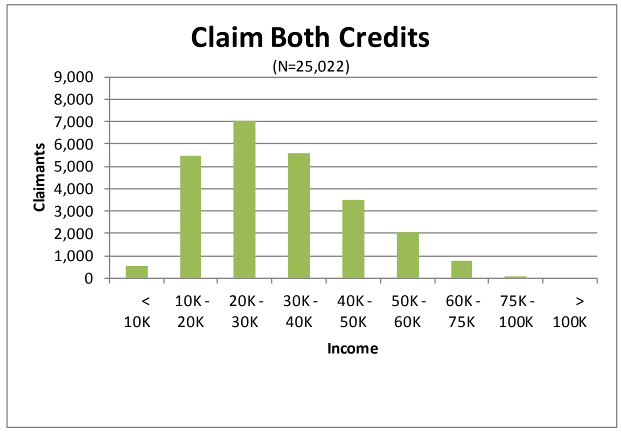
both affordable and of high quality. The Oregon Legislature approached the issue by providing an employer-based incentive that included referral services and on-site care. One of the arguments for this approach is that it could help in recruitment and retention of high-quality employees, particularly in businesses with on-site child care. Some argued it could reduce the cost of direct wages paid by the employer if these were reduced as a result of the extra benefit provided to employees.

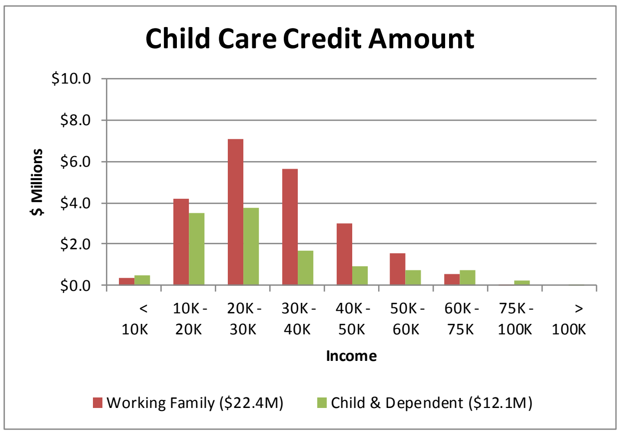
By the mid-1990s, the policy focus in the U.S. had shifted to moving people from welfare to work. Child care remained a significant obstacle in this pursuit. As low wage earners moved up the income scale they would lose the direct subsidy child care payments (as well as other direct benefits) so that, in some cases, their disposable income could remain relatively flat, or perhaps decline, despite a higher hourly wage.

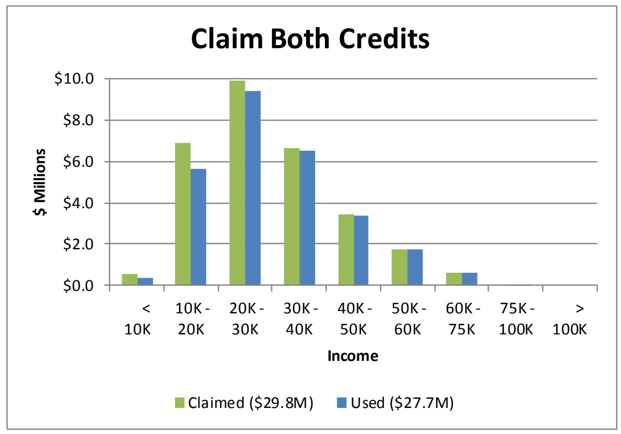
The Legislature responded to this by creating an additional tax credit for child care to be taken by parents. The Working Family Child Care Credit provided a credit for up to 40 percent of child care expenses; it was phased out for taxpayers with incomes above 200 percent of the Federal Poverty Level (FPL). The phase-out range was extended to 250 percent of FPL in 1999 and the credit was made refundable in 2003. There is no limit to the amount of eligible expenses.

The charts below show the use of the Child and Dependent Care (CDC) and Working Family Child Care (WFCC) tax credits for tax year 2012. The top two charts show the number of claimants; the one on the left shows the two credits separately. There were roughly 42,700 full year filers using the CDC and 26,800 filers using the WFCC. The graph reflects that the WFC phases out earlier than does the CDC. The graph on the right contains the roughly 25,000 filers who claimed both tax credits.



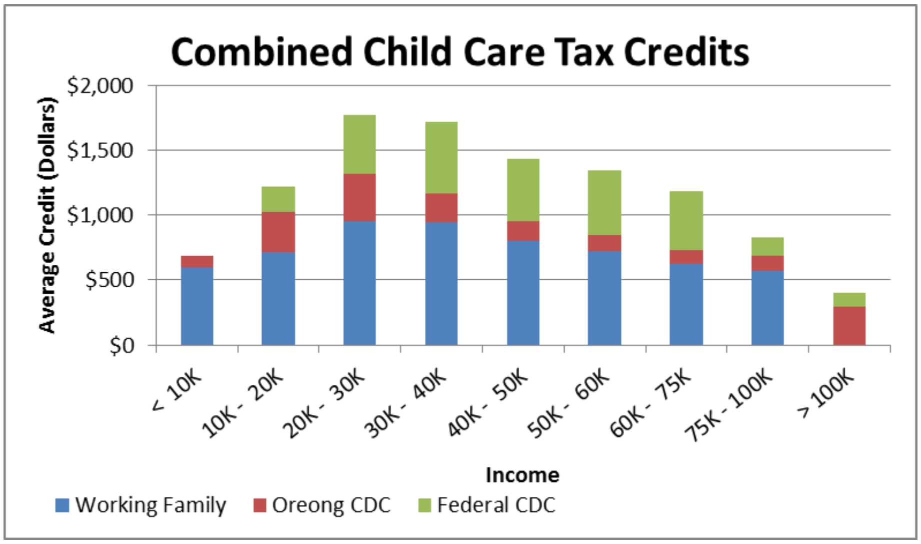






The bottom two graphs are analogous to the top two except they show the dollar amounts involved. The left chart shows that from filers with income below $60,000, more credits are issued for WFC. Higher income groups are ineligible for the WFC but are still able to claim some amount of CDC. The graph on the right shows the combined use of the two tax credits for those filers claiming both tax credits.

The following chart shows the average tax credit amounts for both the WFC and CDC, but also includes the federal Child and Dependent Care tax credit. When combined, they provide a more complete picture of the full tax credit subsidy provided to taxpayers with child care costs.



In 1993, the Child Care Division was created within the Employment Department. One primary purpose of the Division was to administer the federal funds received by Oregon pursuant to the Child Care and Development Block Grant Act of 1990. In 2013, the Legislature moved these functions again, this time to the Department of Education as part of the process of creating the Early Learning Division. This move reflects the general policy blending of child care and early education.

Notwithstanding the goal of improving access to higher quality child care, other research focuses on the use of these tax credits to increase employment among low-income Oregonians. Child care expenses can be a significant obstacle for some taxpayers who are deciding whether or not to enter the workforce. The literature refers to a "reservation wage", which is basically the break-even point where going to work will exactly offset the cost of child care. If the income from working is below this wage, then working will actually reduce the parent's income. Their wage would need to be higher than the reservation wage for work to be financially viable. Different kinds of incentives exist that would effectively increase the wage income. The policy goal of increasing employment among low-income individuals can be (partially) addressed by employment subsidies (e.g. the Earned Income Tax Credit) or child care subsidies (e.g. the Working Family Child Care Credit).

These four policies affect different kinds of taxpayers and result in some differentiation across the beneficiaries. The Child & Dependent Care and Working Family Child Care tax credits directly benefit the parents who are paying the child care expenses. In this case the beneficiaries of the tax credit and the spending policy are identical. In contrast, the beneficiaries of the tax credit for contributions to the Office of Child Care (OCC) are taxpayers who make qualifying contributions; they need not be consumers of child care services. However, the revenue raised by the OCC is presumably used to promote quality, affordable child care options. Ultimately, the beneficiaries of the policy are the families who consume child care services. The remaining credit is structured such that it benefits a different type of entity. Employers who offer qualifying assistance receive the direct benefit of the tax credit. Presumably, however, the families who utilize such services benefit from the assistance in accessing child care services.

In Summary:

Child and Dependent Care	
Advantages	• Leverages federal tax credit and federal dependency rules
Disadvantages	• Amount of limitation on eligible expenses
Potential Modifications	• Increase share of federal credit • Combine with the Working Family Child Care credit

Working Family Child Care	
Advantages	• Refundable
Disadvantages	• No limit on eligible expenses
Potential Modifications	• Change phase-out schedule • Limit eligible expenses • Combine with the Child and Dependent Care credit

Employer Provided Dependent Care Assistance	
Advantages	• Value to employees could exceed cost to employers
Disadvantages	• Potential variation in quality across employers
Potential Modifications	• Focus incentive to on-site child care

Contributions to the Office of Child Care	
Advantages	• Value to state exceeds cost
Disadvantages	• Program cap may not be sufficient to fund need
Potential Modifications	• Change tax credit rate • Change program cap • Change use of funds