CCAC SPECIAL REPORT #1: STATE FINANCING ALTERNATIVES PROJECT

EMPLOYER TAX CREDITS FOR CHILD CARE: ASSET OR LIABILITY?

CHILD CARE ACTION CAMPAIGN
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"Employers have a major role in helping parents find needed child care, but I do not support giveaways of taxpayer dollars to get business to recognize what it already knows: that it must provide assistance for more and better child care. Workers demand it; productivity demands it; a business bottom line demands it."

President George Bush
1988[1]

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Elinor Guggenheimer
President
Child Care Action Campaign

* See Appendix III, page 28, for a roster of National Advisory Panel members who have been especially helpful.

ABOUT THE CHILD CARE ACTION CAMPAIGN

The Child Care Action Campaign (CCAC), formed in 1983, is a national coalition of leaders from a wide range of American institutions: the media, government, corporations, unions, women's groups, academia. Our overall mission is to encourage and support the development of child care policies and programs that will enable parents to work productively and to improve their standard of living.

Our goals:

To expand and improve the national child care system into a comprehensive, coordinated delivery system that provides quality care that is affordable;

To encourage employers to adopt workplace policies that will enable parents to work productively, to improve their standard of living, and to be effective, loving parents.

EMPLOYER TAX CREDITS: ASSET OR LIABILITY?

EXECUTIVE SUMMARY

Changes in the American economy and shifts in demographics are rapidly reshaping the American family and workplace. As a result, corporate leaders and public officials have a growing interest in policies that increase the supply of reliable, affordable child care.

In particular, state legislators have responded to the surging demand for child care by developing policies to encourage more employers to provide child care benefits for their employees; Employer Tax Credits for child care have emerged as the most popular option.

The goals of Employer Tax Credits are:

(1) to provide an incentive to employers to establish some form of child care benefit; and

(2) to increase the supply of care.

In an effort to evaluate the effectiveness of Employer Tax Credits, the Child Care Action Campaign (CCAC) examined quantitative data and conducted extensive interviews with over 100 public officials, corporate leaders, financial analysts, and child care advocates in the 13 states with established Employer Tax Credit policies. CCAC also interviewed individuals in other states that have considered, but so far rejected, such initiatives. CCAC research indicates that Employer Tax Credits, as currently conceived, <u>may</u> induce a limited pool of employers to offer some kind of child care benefit to their employees. But Employer Tax Credits are currently used by less than 1% of eligible employers and have had no more than a marginal effect on the supply of care. Employer Tax Credits by themselves are not a panacea. Instead, they may divert attention from more effective strategies for addressing the child care crisis.

THE APPEAL OF EMPLOYER TAX CREDITS

Proponents of Employer Tax Credits argue that Employer Tax Credits are a low-cost policy that is easy to implement. They also view them as a way to leverage limited public dollars for child care. Accordingly, the popularity of these credits has soared.

In 1983, only four states allowed a tax credit for employers who provided some form of child care benefit to their employees. Today, 13 states provide such a credit: California, Connecticut, Kansas, Maine, Maryland, Mississippi, Montana, New Mexico, Ohio, Oregon, Pennsylvania, Rhode Island, and South

Carolina. Three of these credits were established in 1989. Moreover, during the 1989 state legislative sessions, at least 57 Employer Tax Credit bills were pending in 21 states. In seven of the 13 states with Employer Tax Credits in place, legislation is pending that would expand or improve the policies.

However, the popularity of these tax credits belie their effectiveness.

WHO USES EMPLOYER TAX CREDITS?

CCAC research indicates that even though employers say they want tax credits, they don't use them. Employer tax credits do seem to be attractive to certain types of employers -- those already providing benefits, those seriously considering the implementation of such a program, or those employers for whom cost is truly a barrier.

However, in states with Employer Tax Credit policies in place, very few employers -- less than 1% -- have used them. In Connecticut, which has a relatively well-marketed Employer Tax Credit, only 45 out of 80,000 eligible Connecticut companies are expected to claim the credit in 1989.

THE PROBLEMS WITH EMPLOYER TAX CREDITS

The low rates of use are an indication of the inherent limitations of tax credits for child care.

The Policy Perspective:

From a policy standpoint, Employer Tax Credits tend to be inefficient. As one legislator from Illinois says: "Tax credits....go to all the same businesses who are already reaping the benefits of having child care in the first place. Since some people provide child care anyway, why pay for something they're already doing?...."

Employer Tax Credits can also be potentially expensive: tax credit costs are hard to predict, let alone control. In fact, if usage is encouraged, and, in turn, participation increases, costs will go up. In California, for example, the estimated cost of its Employer Tax Credit Program ranged from $5 to $20 million.

In addition, Employer Tax Credits can sidetrack policy makers from investing more directly in building the current child care infrastructure.

The Corporate Experience:

The available data show, and the corporate leaders CCAC interviewed confirm, that Employer Tax Credits by themselves, do not motivate employers to offer a child care benefit. Companies must first be convinced that child care makes good business sense.

Plus, Employer Tax Credits are an incentive for a limited pool of employers: Only businesses with corporate tax liability can claim an Employer Tax Credit. In Michigan, for instance, less than half of its 190,000 businesses have corporate tax liability. Furthermore, the highest corporate tax credit is 12%, and so, does not tend to be a heavily weighted factor in corporate decision-making. Moreover, as they are currently conceived, tax credit programs favor the coverage of the start-up costs of child care programs, even though operating expenses are often a greater problem for employers and employees alike. Finally, companies are unlikely to take advantage of an incentive which is an administrative burden and which may not be stable over time.

CONCLUSION

At a time when the public and private sectors are struggling to come to grips with a changing labor force and economy, Employer Tax Credits are a passive way to develop child care policy. They can be effective only as part of a comprehensive approach to child care. But even as a piece of a comprehensive funding strategy, Employer Tax Credits are problematic. Employer Tax Credits must be reexamined, or they will continue to offer little to employers, to employees, to a state's child care delivery system, and even less to children.

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PREFACE

An investment in quality child care can have dramatic public and private benefits. It can expand the labor force, enable single mothers to work and to become self-sufficient, help families improve their standards of living, provide children with a healthy head start, and improve employee productivity by reducing turnover, absenteeism, and work/family-related stress.

The current system of child care delivery in the United States provides neither an adequate supply, nor the quality necessary, to ensure that children are well-cared for so that parents can work without distraction. Nor does it enable employers to attract additional workers to a labor force that is currently growing at half its 1970 rate.

Because child care throughout the nation is financed by a patchwork of funding streams, the sum of which is inadequate, the fundamental question facing decision makers is "How can we pay for quality child care?"

Parents can't do it alone. Quality child care is expensive to provide and therefore, to purchase. The average cost of full-time care for one child ranges from $2,000[2] to $3,000[3] per child per year. Data from the National Institute of Child Health and Human Development indicate that poor families pay a larger percentage of their income for child care than non-poor families -- 21 to 25%, compared to 8 to 10%.[4] Families that cannot afford to pay for good care make one of several "choices": they work fewer hours, they buy lower quality or fewer hours of care, they leave their children unattended, or they drop out of the labor force altogether.

Child care is, or can be, financed by a range of sources: the Federal government, state and municipal governments, employers, and parents. There are a variety of financing strategies that can be followed: generate new general state and federal revenues or allocate existing ones to child care; center child care delivery in the public schools and finance it through property taxes; offer financial incentives to employers to encourage them to offer child care benefits to their employees, to name a few. The right mix can make quality child care available for all parents who need it.

This report focuses on state Employer Tax Credits for employers who provide some form of child care assistance to their employees. Employer Tax Credits are only one of many possible ways to fund the expansion of child care. CCAC has focused attention on these credits, in this first of a series of reports on state financing alternatives for child care, because of the growing interest in Employer Tax Credits by legislators eager to establish such policies.

EMPLOYER TAX CREDITS FOR CHILD CARE: ASSET OR LIABILITY?

INTRODUCTION

There is a clear link between an investment in quality child care and economic prosperity, both for individual firms and for the nation as a whole.[5] This connection, along with the changing demographics of the labor force and the revolutionary changes in family life, is motivating elected officials and corporate leaders to pass legislation and initiate new programs that will address the child care crisis millions of American parents experience everyday.

In this, the first of a series of Child Care Action Campaign (CCAC) Special Reports on Child Care Financing Alternatives, CCAC looks closely at one approach that states are using to attempt to increase the supply of child care: <u>Employer Tax Credits for businesses that establish a child care benefit</u>.*

Employer Tax Credits reduce the amount of state taxes due, dollar for dollar, for businesses with a tax liability. While employers can already deduct child care costs from their gross income as a legitimate business expense on their Federal taxes, such deductions reduce the income subject to taxation. Credits reduce the total amount due.[6]

The goal of Employer Tax Credits is twofold:

(1) to involve more employers in providing some form of child care; and

(2) to increase the supply of child care.

Are Employer Tax Credits an effective and efficient use of public resources? Do they generate more child care? Are there better ways to reach the goal and still spend the same amount of money?

In an effort to evaluate the effectiveness of Employer Tax Credits, CCAC examined the quantitative data and conducted extensive interviews with public officials, corporate leaders, financial analysts, and child care advocates in the 13 states with established tax credit policies. CCAC also spoke to individuals in other states that have considered, but so far rejected, such initiatives.

* See Appendix I, page 21 for a more detailed discussion of child care options for employers.

While it is too soon to permit an exhaustive evaluation of the effectiveness of Employer Tax Credits, some preliminary conclusions can be drawn. CCAC's research indicates that Employer Tax Credits may induce a limited pool of employers to offer their employees some kind of child care benefit. But Employer Tax Credits alone have, at best, a marginal impact. They can, however, be one part of an overall state response to the growing need for child care.

The Funding Vacuum

During the 1980's, states played a growing role in addressing the need for better, and more affordable, child care. The Federal government cut back on child care spending which created a funding vacuum and motivated some states to act.[7] But other factors were, and continue to be, at work too. Because mothers of young children are the fastest growing segment of the labor force,[8] and because the number of children and women living in poverty has increased,[9] the need for child care has soared.

State decision makers are struggling to find a way to leverage limited public monies to address the need for child care most effectively. In 1987, 32 states passed approximately 125 pieces of legislation related to child care and early childhood education.[10] In 1988, state legislatures considered more than 500 bills related to child care.[11] An increasing number of state legislatures have created special committees on children and child care.[12] Governors from across the country are establishing task forces on child care and calling for renewed attention to the issue.

But states have been unable to keep up with the skyrocketing demand for child care: 23 states are actually serving fewer children now than they did seven years ago.[13] With limited dollars, and a growing need for child care, states are looking for ways to encourage private sector involvement in child care.

Current Employer Involvement in Child Care

Employers are increasing their role in responding to the child care crisis. Of the nation's six million employers, 4,100 offer their employees some form of child care assistance.[14] That is a 400% increase in just five years. While the employers most likely to offer child care assistance have tended to be large corporations, more and more small to medium-sized companies are becoming involved in child care.[15] However, employers involved in child care still represent a tiny percentage of U.S. employers.

At the same time, the enormous amount of attention that the media pays to employers that offer child care distorts how involved corporations really are: Most employers still don't view child care as a business issue. Even the majority of those considering providing child care benefits to their employees perceive many obstacles to their involvement. Among the perceived obstacles are: the cost of child care aid, potential exposure to equity issues and liability lawsuits, and the difficulty of implementing any kind of new benefit.

Employers who do provide child care benefits to their employees report considerable returns on their investment. Two of the three national surveys on employer-supported child care indicate that the most significant benefit to employers for providing child care is the advantage in recruiting, while the third survey identified retention of employees as the only item ahead of recruitment that is enhanced by providing child care.[16] Accordingly, child care is a particularly attractive option during labor shortages.

Employer Tax Credits: The Top of The List

States are offering a variety of financial incentives, mostly in the form of tax relief, to employers to increase business's currently limited involvement in child care. In addition to Employer Tax Credits, options include Neighborhood Assistance Plans to encourage economic development in low-income neighborhoods, state tax deductions for child care as a business expense, direct grants to employers, and accelerated depreciation of child care costs or investments. A recent survey of state policies on employer-supported child care found that 8 states offer grant programs, 10 states have loan programs, and 16 states provide linked deposit loans.[17]

More and more state legislators are finding Employer Tax Credit programs particularly appealing. In 1983, only four states -- Connecticut, Michigan, New Mexico and Ohio -- had established Employer Tax Credits. Today, 13 states offer Employer Tax Credits: California, Connecticut, Kansas, Maine, Maryland, Mississippi, Montana, New Mexico, Ohio, Oregon, Pennsylvania, Rhode Island, and South Carolina. Three of these passed in 1989. At least 57 Employer Tax Credit bills were pending in 21 states during the 1989 state legislative session. In seven of the 13 states with Employer Tax Credits in place, legislation is pending that would expand or improve the policies. **[See Chart #I, pg.7: Employer Tax Credits: The State of the States.]**

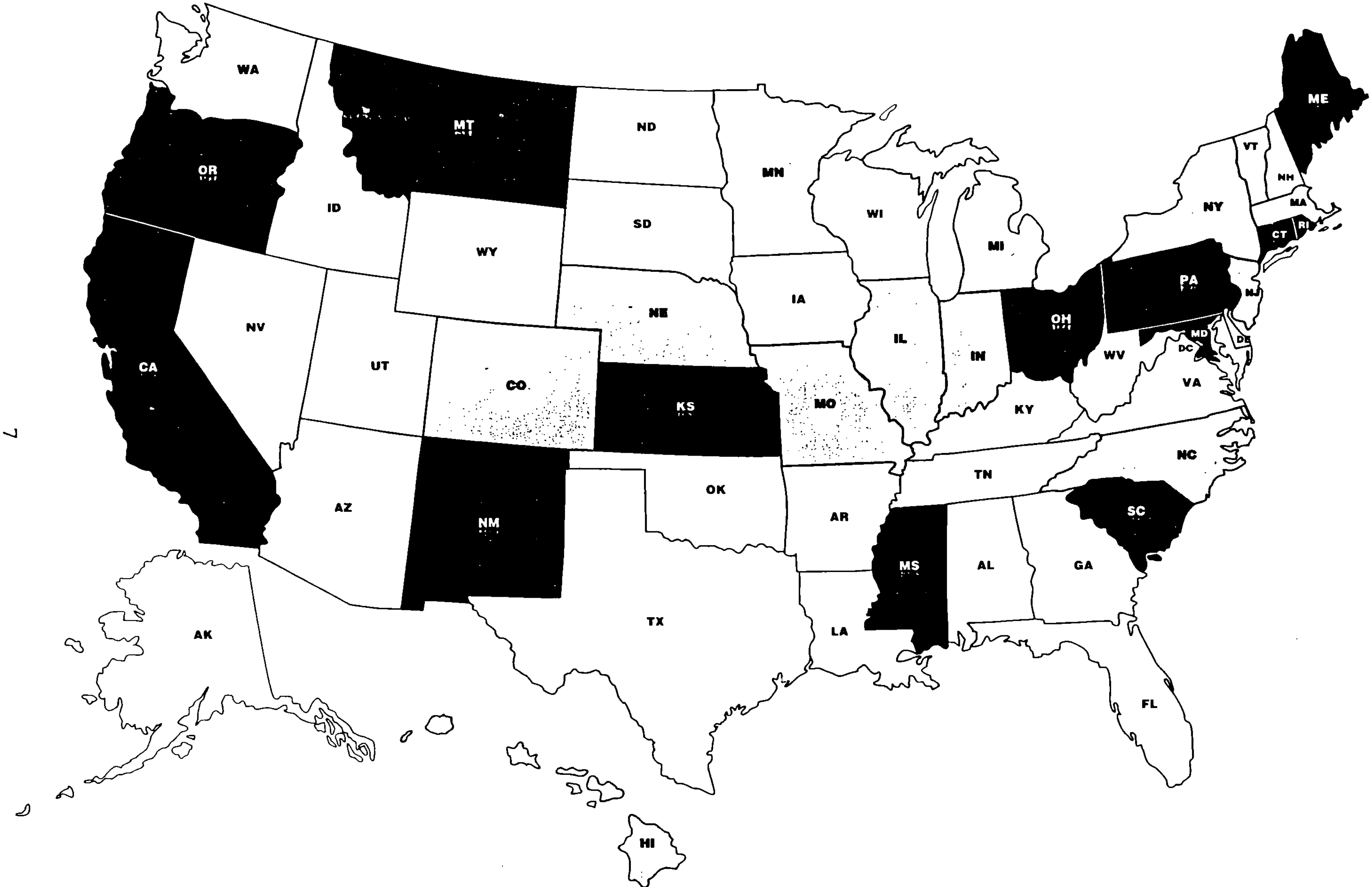
Many state legislators say Employer Tax Credits are important not only for what they are supposed to do, but also for the message they send to employers that the state is committed to child care and to helping employers confront their changing needs. A member of Wisconsin's Lieutenant Governor Scott McCallum's staff says, "Tax credits send a message to employers that the state is putting its money where its mouth is...."[18] Other legislators view Employer Tax Credits as a way to "enlighten the business community" and "to foster public-private partnerships."[19]

Legislators also agree that establishing an Employer Tax Credit via the state tax code avoids the stigma sometimes associated with acceptance of a direct government grant or subsidy.

The business community is attracted to Employer Tax Credits too. National surveys of corporate leaders and CCAC's interviews with employers reveal that employers support tax forgiveness policies, including tax credits, for child care. Seventy-one percent of the 1,511 human resource professionals surveyed by the American Society for Personnel Administration said that employers should be given tax credits for providing child care.[20]

State surveys reflect similar employer support for such financial incentives as Employer Tax Credits. A survey for The New York State Commission on Child Care found that financial incentives were favored by about half the respondents, regardless of the size of the company.[21]

Chart #1 Employer Tax Credits: The State of the States



■ **States with tax credit laws**

□ **States with pending tax credit legislation**

Seven states with employer tax credit laws — California, Connecticut, Ohio, Oregon, Pennsylvania, and Rhode Island — also had bills pending in 1989.

WHO USES EMPLOYER TAX CREDITS?

CCAC research indicates that Employer Tax Credits are attractive to, and can induce, some employers with corporate tax liability to establish child care benefits. However, data from states that do offer Employer Tax Credits show that fewer than 1% of all eligible employers claim these tax credits.

Which Employers Are Attracted to Employer Tax Credits?

1. **Employers who already provide child care benefits to their employees sometimes claim tax credits to expand their current child care benefits.**

According to Paul Proett, Manager of Family Services for Apple Computers in California, the Employer Tax Credit is playing a significant role in the company's tentative plans for doubling the capacity of its child care center from 70 to 140. The company is waiting to see how high its profits are before making a final decision on the expansion of its child care program.[22]

While Apple decided to provide child care before California passed its Employer Tax Credit legislation, it is claiming the credit for its existing program, recovering about $100,000, or more than 20%, of the child care costs. Proett says the Employer Tax Credit program helps, not only in meeting costs, but in appeasing managers who are skeptical about the cost of establishing a child care program.[23]

Minnesota State Senator Glen Taylor, a small business owner and a sponsor of the Minnesota 1989 Employer Tax Credit legislation says: "I don't know that it brings in new employers, but it encourages progressive businesses to expand their child care efforts."[24]

Pam Goodman, Benefits Coordinator at AVIA Athletic Footwear in Portland, Oregon, says that AVIA's decision to establish a consortium-sponsored on-site child care center did not depend on the Employer Tax Credit. However, the credit allowed them to expand their program to include subsidies to employees.[25] If a family's annual adjusted income is $27,000, the family is eligible to receive a 25% subsidy from the company for one child in full-time care, reducing the cost from $98 to $73.50 a week. The center currently serves 11 of 250 employees.[26] Interestingly, their local competitor is now also considering offering a child care benefit.[27]

2. **Businesses that are considering a child care benefit for their employees often view an Employer Tax Credit as a "final motivator" -- a way to speed up the corporate decision-making process.[28]**

Those who can take advantage of Employer Tax Credits for child care tend to see them as "an attractive part of our options," according to Jane Myers, Personnel Manager of Westwood Industries, a furniture manufacturer in Tupelo, Mississippi. The company is considering providing child care benefits to its employees and may claim the Employer Tax Credit.[29]

Sharon Fratantuono, Employee Relations Administrator of Allied After Market, a car parts manufacturer in East Providence, Rhode Island, concurs: Although the availability of the tax credit was not the primary reason for her company's interest in child care, she says it "will help our cause" as the company's child care plan awaits approval.[30]

3. **Many companies that pay relatively low-wages and low benefits, for whom cost may be the main obstacle in a decision to provide child care benefits, say Employer Tax Credits make the difference.**

Margaret Derus, Administrator for Research and Analysis for the Wisconsin Department of Revenue says: "There are a very small number of employers where a tax credit would be a factor in an employer's decision....tax credits would only seem to make a difference to those employers at the margin."[31]

Two such employers taking advantage of Oregon's program said the amount of the credit was <u>the</u> determining factor in their decisions to provide child care assistance. Jo Rymer, General Manager of Pro-Tem, a temporary employment agency in Portland, Oregon, said that after sitting on the fence about whether she could afford to provide child care benefits to her employees, the Employer Tax Credit gave her "the courage to jump in."[32] Another Oregon employer says, "We couldn't have afforded to offer it [a child care benefit] without the tax credit."[33]

Findings of an informal survey conducted by the National Conference of State Legislatures (NCSL) indicate that there are employers for whom an Employer Tax Credit is a factor in the decision to provide child care. Twenty-two of the 34 corporations who claimed the Connecticut Employer Tax Credit in 1988 responded to the survey. NCSL found that 11 of the 22 companies would have provided the employee child care assistance without the credit. The remaining 11 said that the state support was "crucial" in their decision.[34]

However, the survey did not address many of the critical issues: Were the businesses already offering a child care benefit? Would they halt the employee benefit if the tax credit were no longer in place? What did "crucial" mean to the respondents?

The Numbers Game

The effectiveness of Employer Tax Credits is further limited because so few companies take advantage of them. Most of the states with Employer Tax Credit laws have little information available on rates of use, because either there is no tracking mechanism in place or the laws have just recently been passed. Where information about use is available, data show that the number of employers claiming the Employer Tax Credit has been low to non-existent -- less than 1%. [See **CHART #II, pg. 11-12: Elements and Costs of Employer Tax Credit Laws.**]

CONNECTICUT's employer tax credit programs went into effect in 1981. The state offered a 25% credit, to a maximum of $10,000, for the "planning, purchase, or renovation" of a child care center. Between 1981 and 1983, no company claimed the credit.[35] Currently, the law covers the first $20,000, or 40%, of the capital costs of an on-site center and $75,000 or 50% of purchased care expenses. There is a state spending limit of $1,000,000 each. The credit program for purchased care expenses is being used: in 1987, 22 companies claimed the Employer Tax Credit at a cost of $96,000. In 1988, 34 businesses claimed it at a cost of $309,000; and in 1989, 45 companies are expected to file for the Employer Tax Credit, at a cost of an estimated $709,000. Far fewer employers claimed the credit for capital costs. Since 1987, only one company filed for start-up Employer Tax Credit at a cost of $3,640.[36]

MICHIGAN offered its employers an Employer Tax Credit between 1981 and 1983. During that time "no more than a dozen" employers took advantage of the credit.[37]

NEW MEXICO administrators estimate that only one business has ever used its Employer Tax Credit, at a cost to the state of about $2,000 since 1983.[38]

OREGON's Child Care Coordinator Mary Louise McClintock estimates that in the years 1987-1989 fewer than 10 businesses used the credit. For the 1989-91 period, McClintock projects that 25 to 30 businesses will claim the credit for resource and referral services and that four businesses will take advantage of the on-site care option.[39]

RHODE ISLAND Tax Department administrators have no projection for how many employers will use the credit.[40] However, the National Conference of State Legislatures suggests that approximately five Rhode Island employers will claim the Employer Tax Credit in 1988-89.[41]

The use of Employer Tax Credits has increased in only two states -- Oregon and Connecticut -- and even those increases have been slight. In 1989, only 45 out of the 80,000 eligible Connecticut companies claimed the Employer Tax Credit.[42] In Oregon, roughly 40 companies out of roughly 20,490 are expected to claim the tax credit in 1989.[43]

Chart #II Key Elements and Estimated Costs of Employer Tax Credits for Child Care

State	Activity Covered		Maximum Credit	State Cap	Carry Forward/Back	Estimated Cost	Participation Rates	Enactment Date	Expiration Date
California	Purchased Care	50%	$300/Part-time program/ child/year	No	5 succeeding years	1988: $8–9 million	Unknown	1988	1992
		50%	$600/Full-time program/ child/year						
	Start-Up Expenses	30%	$30,000/employer						
	Resource and Referral	30%	$30,000/employer						
Connecticut	Purchased Care	50%	$75,000/employer	$1 million	5 succeeding or prior years	1987: $96,000 1988: $309,000 1989: $709,000	1987: 22 1988: 34 1989: 45	1986	
	Start-Up Expenses	40%	$20,000/employer	$1 million	3 succeeding years	1987: $3,640	1987: 1	1986	
Kansas	Purchased Care (on-site operating only)	30%	$30,000/employer	$3 million	No	Unknown	Unknown	1989	1993
	Start-up Expenses	50%	$45,000/employer						
Maine	Financial Assistance for ex-AFDC Recipients	20%	$5,000/employer or $100/child	No	15 succeeding years or 3 prior years	Unknown	Unknown	1987	
Maryland	Improvements to Real Property		Up to local discretion	No	No	Unknown	Unknown	1987	1991
Mississippi	Purchased Care	25%		No	3 succeeding years	Unknown	Unknown	1989	
	Start-up Expenses	25%							
Montana	"Dependent care actually provided to or on behalf of an employee"	15%	$1,250/employee	No	5 succeeding years	Unknown	Unknown	1989	
New Mexico	Purchased Care	30%	$30,000/employer	No	3 succeeding years	$2,000	1	1983	

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State	Activity Covered		Maximum Credit	State Cap	Carry Forward/Back	Estimated Cost	Participation Rates	Enactment Date	Expiration Date
Ohio	Financial Assistance for Employees in Enterprise Zones		$300/child for up to first two years of employment	No	No	Unknown	Unknown	1982	1992
Oregon	Purchased Care	50%	$2,500/employee	No	5 succeeding years	1987–89: $250,000	Less than 10 businesses	1987	1992
	Resource and Referral	50%	$2,500/employee			1989–91: $700,000	25–30 businesses		
	Start-Up Expenses/ Improvements to Real Property	50%	$100,000/employer or $2,500/employee (can only claim 10%/year over a maximum of 10 years)				2 businesses		
Pennsylvania	Financial Assistance for ex-AFDC Recipients		$600/employee for first year $500/employee for second year $400/employee for third year	No	No	Unknown	0	1985	
Rhode Island	Purchased Care	"30% of 60%" (approx. 18%)	$30,000/employer	No	Purchased Care may not be carried over; others may be carried over for 5 succeeding years if the facility is in operation for at least 6 months	Unknown	Unknown	1988	
	Start-Up/Operating Expenses	30%	$30,000/employer						
	Foregone Rent/Lease	30%	$30,000/employer						
South Carolina	Purchased Care	50%	$3,000/employer	No	10 succeeding years	1989: $1.2 million	Unknown	1989	
	Start-Up Expenses	50%	$100,000/employer						

Start-Up Expenses: Capital investment for establishing an on-site, or near-site, child care center for employees' children.
Purchased Care: The purchasing of child care services for the dependent children of employees, including operating expenses of on-site, or near-site care, unless otherwise noted.
Resource and Referral: The provision of services to help employees find and obtain child care.

Few employers are claiming Employer Tax Credits. Those employers who do not say it is because tax credits for child care do not offer enough of a financial incentive or that they are not yet prepared to make the investment in child care benefits -- with or without an Employer Tax Credit.

The Policy Perspective

Employer Tax Credits: Inefficient...

Policy makers question the wisdom of creating social policy through such passive means as altering the tax code.

Some state legislators, and many economists, argue that Employer Tax Credits alone are an inefficient way to implement any public policy, including one that aims to create more child care. Tax credits are also a poor way to spend limited state public resources. Illinois State Representative Woods Bowman, an economist by training, says:

"Tax credits....go to all the same businesses who are already reaping the benefits of having child care in the first place. Since some people provide child care anyway, why pay for something they're already doing? ....Tax credits cost the state an awful lot of money per kid benefited and they have a negligible impact on the supply of child care."[44]

Dana Friedman, Co-President of Families and Work Institute and Vice-President of CCAC, agrees: "Why are we selling companies on the notion that tax credits are the best incentive," she says, "when they're already getting a financial benefit by providing child care?"[45]

And Potentially Expensive....

Currently, few businesses claim Employer Tax Credits. However, if more employers did, Employer Tax Credits could be potentially expensive.

Employer Tax Credits do not appear in a state's annual budget. Some people, consequently, may think they are "no-cost" or "free".[46] However, any kind of tax credit costs the state in foregone revenues. From a budget analyst's perspective there is no difference between spending $250,000 and not collecting $250,000; either way, the state's coffers are $250,000 lower.

Several states have rejected the idea of an Employer Tax Credit program precisely because of the potential program costs. For example:

The CALIFORNIA Department of Finance opposed the Employer Tax Credit initiative because of the potential major loss in general fund revenues.[47] The state's Franchise Tax Board also did not support the recently passed Employer Tax Credit because of the difficulty in assessing its fiscal effect. The Board estimated that revenue losses could reach $5 million to $9 million. They based their estimates on the following calculations:

1) On Site Child Care Facility Development. Tax revenue lost in the first year would be $150,000, based on a 20% growth rate and use of the maximum credit for start-up of $30,000 ($30,000 x 5 new on-site child care centers).

2) Resource and Referral. Lost tax revenue would total $3.6 million, assuming that 10% of California employers with over 300 employees were to contract with resource and referral agencies with an average contract of $20,000.

3) Financial Assistance. If the total number of employers providing employee child care assistance -- vouchers, for example -- made up 1/10 of 1% of all California employers, the state would lose about $6 million in tax revenues if tax credits were claimed. But they could lose even more -- as much as $20 million annually -- depending on the number of employers who claim the credit.[48]

FLORIDA feared that a well-marketed tax credit program might be "so popular that it would bankrupt the state."[49] Instead, it established a deduction plan for the start-up costs of child care and a grant program to encourage employers to establish child care benefits.

RHODE ISLAND's Division of Taxation resists any attempt to estimate the cost of their program because it is so difficult to assess accurately at this time in their tax cycle.[50]

TENNESSEE considered and then decided against offering Employer Tax Credits in 1987. State officials believed a credit would have drained state revenues too drastically.[51]

A WISCONSIN Department of Revenue report recommended that Wisconsin not institute an Employer Tax Credit for child care. The study found that a 30% Employer Tax Credit, based on federal estimates of the value of the current individual income tax exclusion for employer-provided child care, would cost the state $3.4 million in 1989-90 and $5.6 million in 1990-91.[52]

Employer Tax Credits are popular to some because they are an off-budget item and so, not debated in the context of other social or infrastructure investments. As Ohio State

Representative Jane Campbell says: "If tax credits were an item to go through the normal appropriations process, like money for education....like housing for the homeless, tax credits to employers wouldn't make the cut."[53]

Employer Tax Credits: "Feel Good" Legislation

An Employer Tax Credit is sometimes the only child care policy legislators are willing to consider. It becomes the child care bill, winning out over other worthwhile, and in many cases, more effective, child care initiatives: improving the quality of care; coordinating existing services; increasing the affordability and accessibility of care for parents; and actively encouraging business to participate in the child care solution.* If an Employer Tax Credit bill passes, the legislature may perceive that child care has been "dealt with."

Delaware State Representative Jane Maroney describes tax credits as often a "feel good type of legislation. They're neat and tidy," she says, "but don't deal with the real issues of child care. They do allow a legislator to say 'I'm doing something on child care.'"[54]

The media reinforces this perception by focusing its coverage on Employer Tax Credit programs and employer-sponsored child care, to the exclusion of other legislative initiatives that may actually do more to improve supply and quality and reduce fees for child care. According to one child care advocate: "This small program of tax credits probably receives more publicity than allocations made for real programs...like direct subsidies, state funded day care centers, personal tax credits."[55]

The Corporate Experience

Limited Eligibility

Employer Tax Credits are, in theory, an incentive offered to the whole business community. However, many employers are ineligible to claim such credits. In other cases, employers find the credit of little import.

The highest state corporate tax rate is 12%, which means that many corporations pay very little in state income taxes in the first place.[56] Moreover, some states, like Texas and Nevada, have no corporate tax at all.[57]

* See Appendix II, page 23, for a more thorough delineation of CCAC's comprehensive child care approach.

In the states that do levy corporate taxes, there are many employers who do not have to pay -- not-for-profit entities, government agencies, some insurance companies, and, in those states which allow it, businesses electing "Subchapter S" status in which taxes are paid through personal income tax.[58] For example, the largest providers of on-site child care are hospitals, many of whom are not-for-profit; they will never be eligible to claim Employer Tax Credits.[59] There are also many companies that report no profits, and therefore have no tax liability. Some profitable companies who do business in more than one state can shift income around in order to avoid paying taxes. Of 190,000 business returns in Michigan, for instance, fewer than half had any tax liability.[60] Employer Tax Credits do not induce any of these employers to offer a child care benefit.

Finally, Employer Tax Credits are worth less to employers than is apparent at first glance, because a reduction in state tax liability increases the corporation's federal tax liability.

A Factor in Corporate Decision-Making?

"Employers who understand and need to offer a child care benefit are willing to do so with or without a tax credit," according to Elliot Lehman, Co-Chairman of FEL-PRO, Inc., a gasket manufacturing company. "Tax credits, in and of themselves, are not why business chooses to provide child care....".[61]

Employer Tax Credits, in and of themselves, do not provide, but can be a vehicle, to educate the business community about the rewards of offering a child care benefit to its workforce. Employers must first recognize the potential benefits of addressing employees' child care needs, then they must understand the options available to them, and finally, they must have a clear way of implementing the benefit. As one Massachusetts employer says: "Tax credits will never be a large enough incentive to make it worth it [to provide child care benefits to employees] to those companies who aren't interested in the first place."[62]

Employer Tax Credits: Misdirected Money?

Employer Tax Credits, as currently written, tend to be geared towards expanding the capital available for creating new services. However, because child care is a labor intensive industry, a child care program's operating costs, not its start-up cost, are the more difficult to finance. According to Gwen Morgan, a nationally-respected child care expert who is a Lecturer at Wheelock College and a CCAC Board member, 82% of the on-site centers launched between 1960 and 1974 failed because employers were "....concentrating on start-up, rather than solving the more long-range operation expenses."[63] As one Connecticut employer put it: "it's the operating costs that kill you."[64]

In turn, fewer employers seem to use an Employer Tax Credit geared towards capital. In the three years that Connecticut's tax credit law has been in effect, only one employer, Champion International, has used the capital-oriented tax credit to establish an on-site center for the children of both employees and community residents.[65]

Moreover, Dana Friedman argues, it is important "....to encourage employers to assume on-going operating costs rather than start-up costs, so that fees can be lowered and the program made affordable to more families....Tax credits....solely for start-up costs of day care centers will not ultimately serve the more vulnerable populations about which government should be most concerned."[66]

Is the Government A Reliable Partner?

Employers are also suspicious about any government program, including Employer Tax Credits, on the grounds that what the government gives, the government can take away. In the words of Randy Helfert, Vice-President of Human Resources of ABQ Bank in New Mexico: "Any employer would be hesitant to start a program based on a government program like tax credits."[67] According to Gwen Morgan: "Employers generally have preferred tax approaches....[but] even then, do not participate unless the tax provision is stable over time."[68]

Employers are also deterred by the administrative paperwork involved in gaining access to government incentives.[69]

Although most of the available information on Employer Tax Credits shows that they are an inefficient and expensive way to expand a state's child care delivery system, the number of state Employer Tax Credit bills is expected to increase due to political and fiscal considerations. In the last year, CCAC has received over a hundred inquiries from corporate leaders and policy makers who want to know more about Employer Tax Credits and how to establish them in their states.

States cannot, and should not, rely solely on Employer Tax Credits to finance an expansion of child care. Tax credits can be effective only if they are part of a comprehensive approach to child care, one that aims to make good child care more available to and affordable for all families.

Employer Tax Credits should not top the list of child care proposals at the state level. Lieutenant Governor Howard Dean of Vermont says:

> "Tax credits might be nice because they are a strong signal [to business] because money is involved. But they wouldn't bring many employers into child care. We couldn't provide enough money to really make it happen....and while tax credits [can be] very helpful....are they the best way to spend limited money? I think not....tax credits are not at the top of my list."[70]

Child care resources must be planned for and coordinated at the state level to ensure that there is a continuum of care and that resources are wisely invested and efficiently used. Parents and employers must be able to make informed choices. Employers must be educated about what their options are and how they can finance them. Because all sectors of society -- public and private -- benefit from an investment in quality child care, all sectors should share its costs.

But even as a part of a comprehensive funding package, Employer Tax Credits are problematic. The way tax credits are provided must be adjusted to make them feasible for both states and employers -- and ultimately, of help to employees. If Employer Tax Credits are not, they will continue to fail, even in tandem with other child care financing and policies.

To make Employer Tax Credits more effective, states, employers and child care advocates should:

1. **Expand the Child Care Options Covered.**

Many employers already believe, and some legislators assume, that on-site care is the only option available. In fact, there are many, often more attractive, ways for employers to get involved in child care which should be covered by Employer Tax Credits: enhanced resource and referral, voucher payments, the recruitment of family day care providers, and the establishment of Dependent Care Assistance Plans.[71] Any Employer Tax Credit legislation should cover a variety of child care options.

Because child care is a labor-intensive industry, and operating costs are generally burdensome, Employer Tax Credits need to emphasize contributions for operating or enhancing of existing systems and start-up capitalization equally to serve employees better, at all income levels.

Offering a menu of child care options may also provide an effective way to address the needs of low-income workers, more so than those Employer Tax Credit programs that target employers who employ low-wage workers. Connecticut gives preference to applicant employers who employ low income workers. Pennsylvania and Maine make the Employer Tax Credit program available only to those employers hiring employees who have participated in Aid to Families with Dependent Children (AFDC). These policies, however, can unintentionally reward employers who pay low wages over employers who offer economic opportunity and upward mobility.

2. **Ensure Adequate Incentives.**

The drafters of Employer Tax Credits should ensure that the credits are large enough to induce employers, once they know about them, to use them.

Incentives should also be structured as straight percentages rather than as complicated formulas. Michigan's Employer Tax Credit, now phased out, was calculated according to a complicated formula. The total number of hours of child care provided to each eligible child and paid by the employer were divided by each child's total number of hours by 2,000. The total was finally multiplied by $45.[72] Many argue that this confusing formula contributed to the low participation rate of employers in the program.

3. **Guard Against Overall State Ceilings.**

States should avoid setting a ceiling on the amount of money that employers can claim for credit. Such ceilings may discourage the participation of the very employers the credit is intended to attract.

Ceilings may also make a state wary of marketing the credit aggressively. For example, a report to the Connecticut General Assembly in January, 1989 warns: "A measured approach to marketing is imperative to avoid the necessity of shutting off applications when the annual ceiling is achieved."[73] The success of any credit depends on convincing employers that their investment in child care makes good business sense, and encouraging them to use the credit.

4. **Institute Fiscal Accountability.**

The need to give employers a financial incentive must be balanced against how much the credit costs the state, and, whether it will drain funds from other, more direct, child care programs. The total cost of Employer Tax Credit programs is difficult to predict, let alone control. The program carries a small price tag when only a few employers take advantage of it. Yet, this limited response undermines the purpose of the legislation -- to stimulate the creation of more affordable child care by employers.

5. **Develop a Marketing Plan.**

Establishing an Employer Tax Credit is not enough to encourage employers to become involved in child care. A state must also market the package. Employers must be told about the credit, and be clearly instructed on how to claim it. They should also be briefed on what other child care options are available to them, and how they can implement them.

In 1988, the Connecticut Department of Human Resources' Bureau of Evaluation and Review surveyed Connecticut employers to find out why so few employers took advantage of the Employer Tax Credit. They found that the lack of participation was a result, in part, of poor marketing.[74]

Good marketing would increase the use of tax credits and the benefits of child care to employers as well as increase their understanding of the state's commitment to child care. It would, of course, also increase the total cost of the Employer Tax Credit program.

6. **Establish an Annual Reporting Mechanism.**

For Employer Tax Credits to be adequately evaluated, data must be collected through a built-in mechanism on an on-going basis. Currently, Connecticut is the only state that has available data on the number of employers who claim the credit, the type and size of those employers, the cost to the state, and the impact on child care for the state. Other states that have a tracking mechanism include California, New Mexico, Oregon, and Rhode Island.[75]

7. **Work with the Business and Child Care Communities.**

Employer Tax Credit programs should be developed in partnership with the business and child care communities.

APPENDIX I

Employer-Supported Child Care: Current Options and Trends

U.S. employers first provided child care assistance during World War II when women were actively recruited into the labor force and child care was considered a necessary incentive in the overall war effort.

Today, an estimated 4,100 employers across the country provide some form of child care assistance to their employees. Many of these employers are hospitals or high growth companies that want to attract and retain trained workers. The nationwide increase in the number of two-earner couples and single parents, along with the decline in the growth of the labor force, is leading more and more employers to consider the advantages of providing child care assistance.

In the early 1970's, most companies thought of an on-site day care center as the only way to meet employees' child care needs. Today there is both interest in, and experience with, a range of employer supported child care options:

PROVIDING DIRECT SERVICES

On-site or near-site centers. Companies may own and operate their own child care facility, construct a center and donate it to non-profit employee-operated groups, or contract with a for-profit or not-for-profit organization to run a center for company employees.

Consortium centers. A group of employers, sometimes together with a community agency and/or a union, may form a not-for-profit corporation to fund a day care center conveniently located to all firms contributing to the consortium.

Family day care networks. Employers contract with local agencies to recruit, train, and assist people to become licensed child care providers in their own homes. Family day care programs may be particularly appropriate for infants and can offer flexible hours for people who work odd shifts.

Emergency services. Employees report that making emergency arrangements -- especially when a child is mildly ill -- can be especially difficult. Employers can help pay for special sick child infirmaries or family day care homes, or for health care workers who go to the child's home.

Summer day camps. These are often organized by community agencies or unions and partially subsidized by the company.

PROVIDING INFORMATION

Child care resource and referral programs (CCR&R). These services are provided through in-house sources or by contract with a community based resource and referral agency. They may inform employees about the different forms of child care in the community: part and full day centers, family day care, group family day care homes; know which programs have vacancies and have detailed information about each service; help parents choose the best arrangement for their child; help new child care programs get started; and speak out on child care issues.

Parent education seminars. Staff or outside consultants organize forums to inform working parents about resources in the community and to provide support on work and family issues.

PROVIDING FINANCIAL ASSISTANCE

Child care benefits. Subsidy and discount programs, Dependent Care Assistance Plans (DCAP) or reimbursement accounts for child care may be used to assist eligible employees with all or part of their child care costs.

Flexible or cafeteria-style benefits. Such plans offer child care as one of a range of optional benefits and allow employees to choose an employer-subsidized package best suited to meet family needs. This allows the employer to offer child care to employees without increasing the total cost of benefits.

Salary reduction or salary set-aside. An employee may elect to exchange a portion of salary for a non-taxable child care benefit.

Voucher programs. An employee may select a child care program and submit an employer-financed voucher to the provider, to cover all or part of the cost of the services. This alternative gives parents full responsibility for choosing their child care provider.

PROVIDING FLEXIBLE PERSONNEL POLICIES

Employers can support the child care needs of their employees by instituting various flexible personnel policies--often with no increase in direct benefit expenses. These include flextime, sick child care leaves, part-time schedules, job-sharing, extended maternity and paternity benefits, and work-at-home plans.

Establishing such policies lets employees know that the employer is aware of and concerned about employees' efforts to balance the demands of work and family life. The option, or set of options a company selects will depend on the particular needs of management, employee needs and preferences, and community resources.

APPENDIX II

CCAC's Recommendations for a Comprehensive Child Care Policy for The United States

I. WHAT THE FEDERAL GOVERNMENT SHOULD DO

The Federal government's involvement in child care is itself a patchwork of demand and supply-side subsidies, with no overriding policy to guide the development of additional supply, to increase access or to improve quality. Therefore, it should:

1. Establish a national child care office.

There is no single Federal department or agency to plan or coordinate the Federal government's role in providing child care. The mushrooming demand for child care at all income levels makes Federal leadership for child care imperative. The Federal government's role must be to provide leadership that encourages Federal, state, local and private funds to help parents pay for care; to establish minimum regulatory standards; to provide technical assistance to the states; and to collect data on the changing supply and demand for child care, and on parental preferences.

2. Establish a new and separate funding stream for child care.

The overwhelming requirement for expanding the supply and improving the quality of child care is for significant new investment to make child care more affordable. The administrative anarchy of current child care assistance is paralleled by the inadequate amount of Federal money that is allocated for child care.

The financing mechanism should be a stable source of funds, safe from the vagaries of politics. It must be separate from Title XX, the Social Services Block Grant. It should provide a basis for states and localities to plan and coordinate the appropriate use of their own resources. The monies could come, for example, from general tax revenues, or a separate Social Security-like trust fund. The national Office of Child Care could administer the funds, and monitor their use.

3. Maintain the Dependent Care Tax Credit.

The shifts in the economy and the labor force, coupled with the high cost of quality child care, mean that all families need at least some help with child care. The Dependent Care Tax Credit is one form of such assistance. Child care is an expense incurred in the process of generating income. The Dependent Care Tax Credit recognizes that families who must pay for child care in order to work have less money available to pay taxes than families with the same income who do not need to pay for child care. The credit should be higher at lower income levels, and be reduced progressively as income increases until it reaches zero at the point of affordability. The cap on annual expenditures should be raised, to reflect current market realities and the need to pay high salaries to caregivers. Making the credit refundable, in conjunction with these other adjustments, would also enable low-income families to increase their earnings and help them to move out of poverty.

4. Expand Head Start.

The current incarnation of Head Start is inadequate for two reasons. First, it is almost universally a half day program. Working parents must make other child care arrangements for their children for the other half of the day. Second, Head Start has never been able to serve more than 16 to 17% of eligible children. The overwhelming majority of poor three and four-year-olds, along with their younger counterparts, are excluded from the programs.

5. Establish Federal regulations on minimum standards.

Child care standards currently vary from state to state. In some states, the regulations are consistent with what we know about quality. In others, they fail to guarantee even minimal levels of safety and health for the children in care. Moreover, employers interested in providing some form of child care benefit are bewildered by the wide variation in standards from state to state.

There are several components of quality which can be quantified, and which are essential to basic levels of health, safety and sound developmental practice: child/staff ratios; group size; training of providers; parental access; health and safety standards.

The Federal government should set minimum standards in these five areas, in consultation with national experts and the states.

6. Raise direct subsidies to parents.

Parents now bear most of the cost of child care. Many cannot afford the average cost of care. Raising standards of child care usually means that the cost of child care increases. Therefore, raising quality means helping parents to pay for that part of child care that they cannot afford, so that they are able to keep their children in quality child care.

Subsidies should be based on a sliding fee scale. The top of the scale should be set at the point of affordability, enabling parents to use the same care as their income rises.

7. Provide job-protected parental leave.

Family leave is an essential component on the child care continuum. Parents must be able to adjust to their new role during their first months as a family and require time to learn about their child's needs as well as to find quality, affordable child care. They should be able to do so without worrying about losing their jobs or their incomes.

8. Encourage greater use of public school facilities for child care programs.

The school day and school year are still based, in most communities, on the needs of an agrarian society. The public schools should house before and after school care especially for school-age children and should include pre-kindergarten facilities. The programs should cover longer days, or should establish close links, including transportation, with other child care resources in the communities. They should offer developmental education for children from kindergarten through second grade, and developmental programs for four-year-olds, where they are needed and where schools want to expand their responsibilities.

The Federal government should fund pilot programs to help schools test models of school-based child care programs, which involve community-based organizations in the provision of services.

9. Collect and disseminate data.

The Federal government should collect and publish, on a regular basis, information about the supply of child care, the salaries of caregivers, the use of child care, and the fees paid. Data collection on consumer demand should be integrated into the Consumer Population Survey. Information on consumer demand can be gathered from resource and referral agencies, which have excellent knowledge of local needs and preferences.

II. WHAT STATE AND LOCAL GOVERNMENTS SHOULD DO

Because of the wide variation in the strength and stability of state economies, the Federal government needs to develop an overall policy in support of -- and funding for -- the child care needs of families. The states need to develop specific plans and programs to satisfy the child care needs of their constituents. They also need to increase their investment in child care commensurate with the benefits they get from improving and expanding child care within the state: an improved business climate, higher tax revenues, reduced welfare costs. Therefore, state and local governments should:

1. Raise the professional status and working conditions of child care providers.

Trained child care professionals are essential to the quality of the delivery system. Another major component of quality -- consistency of care -- is jeopardized by a turnover rate among child care providers that averages 60% annually. Unfortunately the low pay and low status of child care providers makes it difficult to attract and retain the quality providers that children need, and that are such an important part of quality child care programs.

To redress these inequities, providers' salaries must be raised. Benefits, such as health insurance, workers' compensation and unemployment insurance must be provided. Improving training opportunities is crucial too. States should establish loan programs that will enable potential child care providers to get the training they need, and allow those already working in the field to continue to develop their professional skills.

2. Implement minimum Federal standards and improve regulations.

Although the Federal government should be responsible for establishing minimum standards for child care, the states should have the job of administering these regulations and of adopting additional standards that meet the particular needs of families in their areas. Their role should include assessing the child care needs of state residents, setting up licensing and regulating procedures, monitoring compliance with the regulations, and offering technical assistance to child care centers and child care providers.

3. Establish loan and grant programs to finance start-up and renovation costs, and to assist with purchasing equipment.

Grants and low-interest loans to finance initial start-up costs, renovation costs, and to help buy equipment will enable child care providers to comply better with minimum health and safety standards, as well as to maintain and improve the quality of programs.

4. Establish school-age child care programs.

Surveys in local communities find that as many as 25% of all school age children are on their own for some part of the day. States should establish before and after-school child care programs for these students, taking into account these students' transportation needs.

5. Make child care part of any welfare reform initiative.

Many studies have shown that lack of affordable child care prevents many single mothers on AFDC from looking for a job, keeping a job, or seeking job training. The success of welfare reform initiatives in California and Massachusetts is attributed, in part, to the large child care component of each. Single mothers cannot enter the labor force without affordable child care. States' provision of child care as part of welfare reform should include care during job training, while mothers make the transition to the work force. Once they have been employed, states should ensure that these families will continue to have access to subsidized care.

6. <u>Expand resource and referral programs</u>.

The success of any national system of child care depends on the extent of the involvement of state and local governments; planning and coordination cannot come simply as directives handed down from the Federal government. Local resource and referral agencies, which rely for funding on public and private sources, are able to assess the child care needs of their constituents, and then provide guidance that will mold programs to fit those needs. One aspect of their involvement could include working with local employers, to design child care assistance programs that meet and fulfill the needs of parents and corporations.

III. <u>WHAT EMPLOYERS CAN DO</u>

See Appendix I.

IV. <u>WHAT PARENTS AND THE PUBLIC NEED TO DO</u>

In child care, parents are the most important constituents -- both for themselves, and as their children's representatives -- and more than likely, they have the least amount of time. Therefore, Child Care Action Campaign suggests that parents:

1. <u>Speak out about their child care needs and ask for quality support.</u>

There are few roles as important as being a parent. In this rapidly changing world, to assume this role responsibly, parents need options. Parents have to do more than realize that child care is not a personal problem, it is a public concern. They must insure that policy-makers hear and address their concerns.

Parents need to talk about what their families need---what's available and what's lacking; participate in local discussions; write to legislators; look up voting records; bring up child care with their employers. Collectively, parents can rapidly move the issue further on the agenda.

2. <u>Create support groups.</u>

3. <u>Parents must understand that fathers are parents, too -- and that they must participate in child care efforts.</u>

APPENDIX III

While the opinions and analysis contained herein are CCAC's, the following CCAC National Advisory Panel members were especially helpful in our research:

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The Honorable Jane Maroney
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Faith Wohl, Director of Workforce Partnering
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The Honorable Helen Gordon Davis
State Senator
Florida

Susan Muenchow, Chief
Department of Health and Rehabilitative Services
Florida

The Honorable Woods Bowman
State Representative
Illinois

Elliot Lehman, Co-Chairman
FEL-PRO Incorporated
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Carol Stein, State Public Affairs Chair
National Council of Jewish Women
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The Honorable Kathleen Sebelius
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Dr. Daniel Lazorchick, Consultant
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Bill Hankins, Policy Analyst
Governor's Human Services Cabinet
Michigan

The Honorable Glen Taylor
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Chairman, Taylor Corporation
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Billie Warford, Director
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Morton Goldfein, Senior Vice-President, Law & Public Affairs
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Betty Anderson, Partner
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The Honorable Howard Dean, M.D.
Lieutenant Governor
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Martha Norris Gilbert, Director
Department for Children
Virginia

Billie Young, Child Care Coordinator
Seattle Department of Human Resources
Washington

The Honorable Scott McCallum
Lieutenant Governor
Wisconsin

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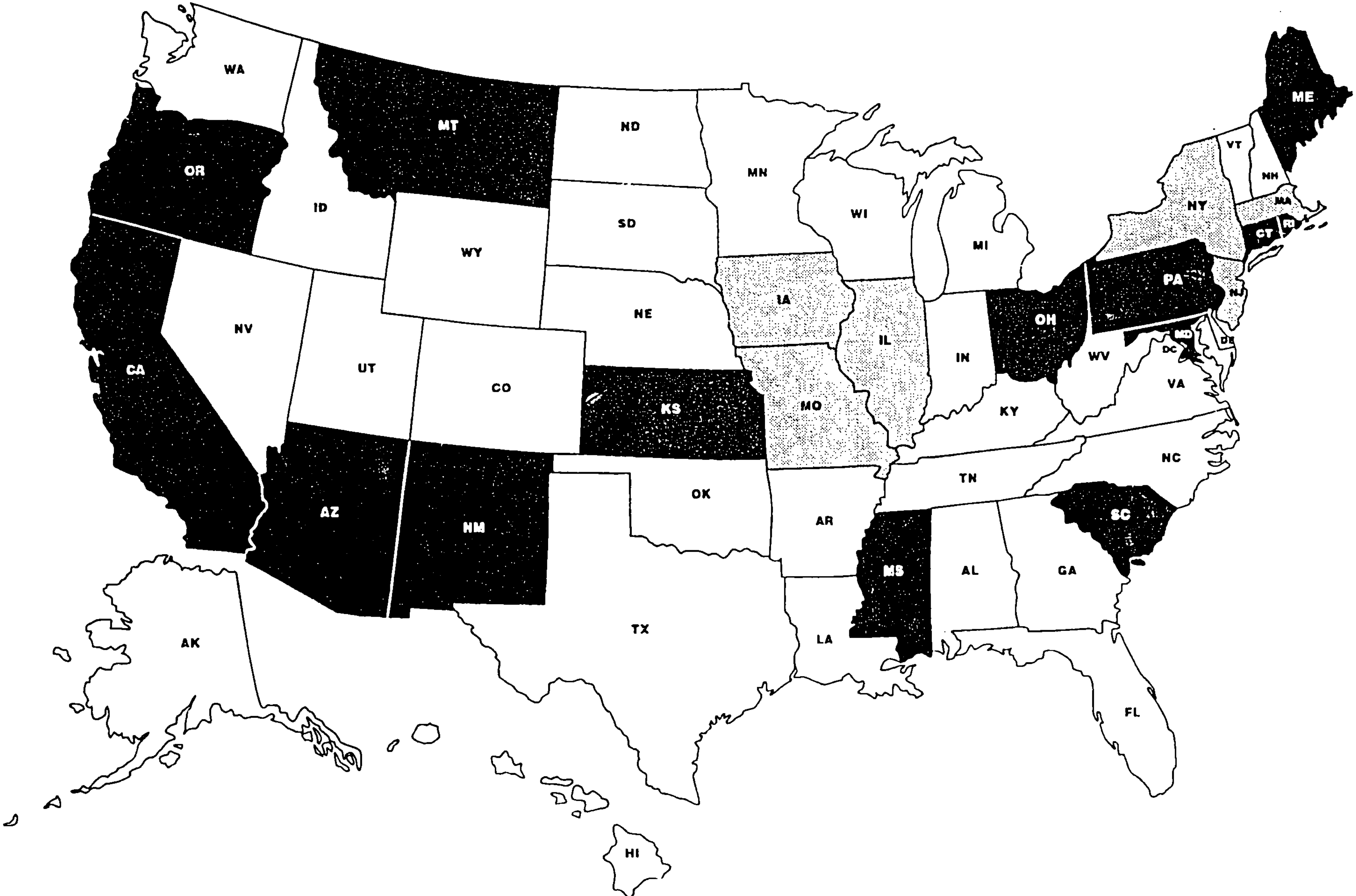
Chart #I Employer Tax Credits: The State of the States in 1991



■ **States with tax credit laws**

▨ **States with pending tax credit legislation**

In 1989, 14 states had tax credit legislation pending. They were: Colorado, Hawaii, Illinois, Indiana, Massachusetts, Michigan, Minnesota, Missouri, Nebraska, New Jersey, New York, North Carolina, Vermont, and Washington.

Chart # Key Elements and Estimated Costs of Employer Tax Credits for Child Care

State	Activity Covered		Maximum Credit	State Cap	Carry Forward/Back	Estimated Cost	No. of Employers Taking Advantage of Credit	Enactment Date	Expiration Date
Arizona	Expenses Related to the Provision of Day Care Facilities and Services	30–50%	Lesser of $15,000 or 50% of facility cost or lesser of $5,000 or 30% of cost to operate or provide service		No	1991: $45,000 FY 91-92: $475,000	1991:0	1991	1995
California	Purchased Care	50% 50%	$300/Part-time program/ child/year $600/Full-time program/ child/year	No	5 succeeding years	FY 88–89: under $1 million FY 89–90: $3 million FY 90–91: $6 million FY 91–92: 9 million	Unknown	1988	12/31/91
	Start-Up Expenses	30%	$50,000/employer						
	Resource and Referral	30%	$50,000/employer						
Connecticut	Purchased Care	50%	$75,000/employer	$1 million	5 succeeding or prior years	1987: $96,000 1988: $309,000 1989: $709,000 1990: $718,400	1987: 22 1988: 34 1989: 45 1990: 48	1986	
	Start-Up Expenses	40%	$20,000/employer	$1 million	3 succeeding years	1987: $3,640 1989: $11,360 1990: $60,600	1987: 1 1989: 4 1990: 4	1986	
Kansas	Purchased Care (on-site operating only)	30%	$30,000/employer	$3 million	No	1989: $46,367	3	1989	1993
	Start-up Expenses	50%	$45,000/employer						
Maine	Start-Up Expenses Purchased Care Resource and Referral	20%	$5,000/employer or $100/child whichever is less	No	15 succeeding years or 3 prior years	Unknown	Unknown	1987	
Maryland	Improvements to Real Property		Up to local discretion	No	No	Unknown	Unknown	1987	1991
Mississippi	Purchased Care Start-Up Expenses	25% 25%	of eligible expenditure not to exceed 50% of income tax liability in a tax year	No	[illegible] succeeding years	Unknown	Unknown	1989	
Montana	"Dependent care actually provided to or on behalf of an employee"	15%	$1,250/employee	No	5 succeeding years	1989: $17,000	Under 100	1989	[illegible]

(Continued)

State	Activity Covered		Maximum Credit	State Cap	Carry Forward/Back	Estimated Cost	No. of Employers Taking Advantage of Credit	Enactment Date	Expiration Date
Mexico	Purchased Care Start-Up Expenses	30%	$30,000/employer	No	3 succeeding years	$2,000	1	1983	
Ohio	Financial Assistance for Employees in Enterprise Zones		$300/child for up to first two years of employment	No	No	Unknown	Unknown	1982	12/31/92
Oregon	Purchased Care Resource and Referral Start-Up Expenses/ Improvements to Real Property	50% 50% 50%	$2,500/employee No maximum $100,000/employer or $2,500/employee (can only claim 10%/year over a maximum of 10 years)	No	5 succeeding years	1987–89: $250,000 1989–91: $700,000	Less than 10 businesses 30–40 businesses 2 businesses	1987	12/31/91
Pennsylvania	Financial Assistance for Employees Receiving Cash Assistance from the State		$600/employee for first year $500/employee for second year $400/employee for third year	No	No	Unknown	Unknown	1985	
	Activities related to the Provision of Child Care Facilities and Services	50%	$250,000/corporation	Yes	Up to 5 years	1990: $125,1000	1990: 30	1967	None
Rhode Island	Purchased Care	"30% of 60%" (approx. 18%)	$30,000/employer	No	Purchased Care may not be carried over; others may be carried over for 5 succeeding years if the facility is in operation for at least 6 months	Unknown	Unknown	1988	
	Start-Up/Operating Expenses	30%	$30,000/employer						
	Foregone Rent/Lease	30%	$30,000/employer						
South Carolina	Purchased Care Start-Up Expenses	50% 50%	$3,000/employer $100,000/employer	No	10 succeeding years	1989: $1.2 million	Unknown	1989	

Start-Up Expenses: Capital investment for establishing an on-site, or near-site, child care center for employees' children.
Purchased Care: The purchasing of child care services for the dependent children of employees, including operating expenses of on-site, or near-site care, unless otherwise noted
Resource and Referral: The provision of services to help employees find and obtain child care.

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New York, New York 10013
(212) 334-9595

Tax incentives for businesses providing employee child care

Senator Kohl's proposal

Senator Kohl's proposed credit would equal **50 percent** of qualified costs incurred, but not to exceed $150,000 per year, and would be in effect for **two years**.

Qualified expenses under the Kohl proposal would include costs incurred:

(1) to acquire, construct, rehabilitate, or expand property which is to be used as part of a qualified child care facility of the taxpayer;

(2) for the operating costs of a qualified child care facility of the taxpayer, including the costs of training and continuing education for employees of the child care facility;

(3) under a contract with a qualified child care facility to provide child care services to employees of the taxpayer; or

(4) under a contract to provide child care resource and referral services to employees of the taxpayer.

Treasury's Modifications

- Apply a **25 percent** credit to qualified child care costs. A 50 percent credit is significantly larger than every existing major business credit and will invite difficult compliance and administrative difficulties.

  - A 25 percent business credit is very large. It is larger than the R&E credit (20 percent); the old investment tax credit (20 percent); credits for investment in rehabilitation, energy and reforestation (10 percent); low-income housing (roughly equivalent to a 9 percent annual credit); empowerment zone employment (20 phased down to 5) and Indian employment (20 percent).

- Make the credit **permanent**;

  - A permanent credit is likely to have a larger stimulative effect, because it gives firms a longer planning horizon and more opportunities to be educated about its advantage.

- Give a **10 percent** credit for the costs of child care resource and referral services;

  - Subsidizing child care resource and referral services at a lower rate addresses concerns that the costs of resource and referral services can be easily inflated by engaging in token efforts to provide these services. It was clear that Senator Kohl's staff felt it necessary to include subsidies for resource and referral services. Treasury preferred not to include these, so we split the difference.

- Require that at least 30 percent of the enrollees in the child care facility be children of the taxpayer's employees;

- Disallowing the credit when less than 30 percent of enrollees are the children of employees prevents a taxpayer from using the credit to subsidize a child care center that primarily serves children unrelated to the taxpayer's employees.

- Disallow the credit for costs for which the taxpayer has been reimbursed by employees, so businesses are receiving the credit only for actual costs of providing child care.

Budgetary cost

- Treasury estimates that the permanent proposed 25 percent credit will cost $490 million through 2003 and $1.3 billion through 2008.