Using Tax Credits to Help Address Child Care Challenges

Availability, Quality and Affordability

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Background

Pre-COVID-19, with nearly 82% of Nebraska mothers of children under age 6 in the workforce,[1] Nebraska ranked 5th highest among all states for working mothers of young children.[2] At the same time, the supply of child care fell short of meeting the needs of Nebraska working parents.

An October 2020 report by the Bipartisan Policy Center found that 90 of the state's 93 counties did not have enough child care to meet the needs of working parents with children under age 6.[3] While statewide the gap between child care slots compared to the need for child care for young children was 18.5%, 35 counties had less than half the child care capacity to meet the needs of working parents.[4] And, another 19 counties had a capacity gap of 30%-49% compared to the needs of working parents with young children.[5]

The supply of child care is a concern because it impacts not only the ability of parents to work, but also employers and state revenue. *The Bottom Line* report released in August 2020 by the University of Nebraska, commissioned by First Five Nebraska,[6] found that inadequate quality child care causes a direct annual loss of:

- $489.3 million in individual income,
- $234.3 million in employer income, and
- $21.1 million in revenue for the state.

With Nebraska's unemployment rate nearly down to the level from last January and February (about 3%),[7] it is time to start addressing the child care shortage. Working parents depend on it.

Related to the supply of child care is the need to ensure the child care workforce (center-based and home-based early care and education professionals):

- Have the competencies and skills to best promote the healthy development of children, and
- Are paid wages aligned with their education, credentials, and experience.

Nebraska's *Core Competencies for Early Childhood Professionals* describes what adults who work with young children need to know, understand and be able to do.[8] At the same time, the current low wages of individuals working in child care, about $11.12 per hour ($23,140 per year),[9] have led to 27% of home-based providers and 20% of center-based staff relying on public assistance to sustain their households.[10]

As a result, the Nebraska Early Childhood Workforce Commission found turnover as high as 26% in some early care and education settings.[11] This makes supply, workforce competencies and pay interrelated.

Child care is a business. Because child care is largely a private-pay market (i.e., a market driven by parents who pay fees for child care services), and parent fees comprise the operating budget for most child care settings, multiple strategies are needed to address market challenges.

Tax credits can help spur the market

Tax incentives are one of several strategies to help spur investment where the market alone is insufficient. The 2019 Nebraska Tax Incentives annual report to the state Legislature found:[12]

- 43 states have job-related tax credits,
- 34 states have market investment tax credits,
- 20 states have sales/use tax refunds on qualified investments, and
- 18 states have personal property tax abatements.

Each of these tax incentives is a way to invest in areas where state legislatures have found the current market to fall short. With regard to the child care market:

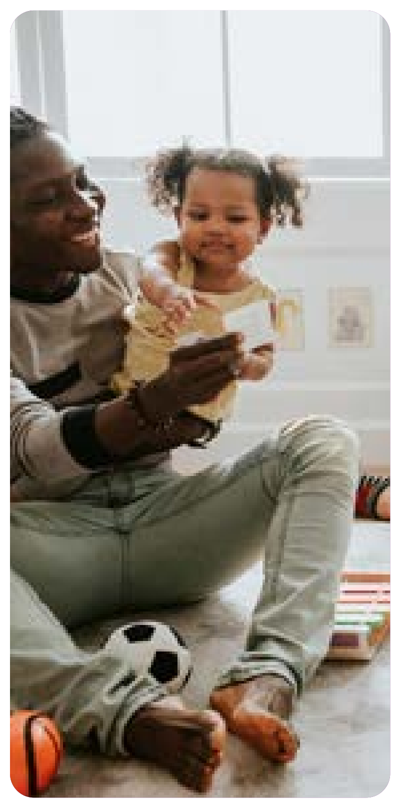
- 18 states have some type of employer-based child care tax credit or incentive (with nine of those states having more than one type of child care-related tax credit),[13] and
- 29 states have some type of credit or incentive to make child care more affordable for families.[14]

Despite incentives in Nebraska's tax code to stimulate quality improvement of child care programs and increase access to subsidized care, there are few incentives to actually address the supply side of the state's child care infrastructure.

Child care tax incentives in Nebraska

The current tax code in Nebraska provides incentives to help address the quality and pay of the child care workforce, to help incent child care providers to serve children whose care is paid for with a child care subsidy, and to help support affordability for families.

Current Nebraska tax incentives do not address the supply shortage of child care—where the market fails to meet the need for child care by working parents. In addition, current incentives are insufficient to support the need for high-quality child care (i.e., high-quality child care costs more to provide, but current incentives fall short of supporting these higher costs).



Child care workforce

To help strengthen the quality of the early care and education workforce, the School Readiness Tax Credit of the Nebraska tax code provides a refundable tax credit for individuals employed for at least six months in a program that participates in Nebraska's Step Up to Quality Program.[15]

The amount of the tax credit is associated with 1-4 levels of achievement based on points earned for an individual's level of education, hours of training and years of work experience.

Nebraska's School Readiness Tax Credit Act includes refundable and nonrefundable tax incentives designed to encourage participation in, and progress through Step Up to Quality, the state's child care quality rating and improvement system.

For example, an individual who has worked for at least six months in a program that participates in Step Up to Quality and who has a Child Development Associate degree would be eligible for a tax credit of $532, which represents Level 1. An individual who has amassed 13-15 points (based on level of education, hours of training and years of work experience) would receive $1,597 for a Level 4 tax credit. The value of the credit at each level is adjusted annually for inflation.

Child care providers

To help incentivize child care providers to serve children whose care is paid for with a child care subsidy and also incent higher quality ratings as part of Nebraska's Step Up to Quality program, the School Readiness Tax Credit of the Nebraska tax code provides a tax credit based on the number of children served who receive a subsidy and the quality rating of the program.[16]

The nonrefundable tax credit is equal to the average monthly number of children whose care is paid for with a child care subsidy multiplied by a per-child dollar amount, which increases as step levels increase (e.g., Step 3 programs receive a $250 per-child tax credit for each child whose care is paid for with a child care subsidy; Step 4 programs receive $500 per child and Step 5 programs receive $750 per child).

Both the workforce and child care provider tax credits are authorized under the School Readiness Tax Credit Act, which was first authorized in 2016. The total amount of tax credits that can be claimed under both incentives is capped at $5 million annually.[17] The program will sunset in 2022.

Family child care affordability

To help make child care more affordable for parents, the Nebraska tax code provides:

- A nonrefundable tax credit equal to 25% of the federal child and dependent care tax credit for parents with adjusted gross income greater than $29,000,[18] and

- A refundable tax credit based on the federal child and dependent care tax credit for parents with adjusted gross income less than $29,000. For parents with income of $22,000 or less, the credit is worth 100% of the federal child and dependent care tax credit. The percentage of the credit that can be taken is reduced by 10% for each $1,000 by which federal adjusted gross income exceeds $22,000 up to $29,000.[19]

The combined cost of these two family child care tax credits was estimated at $11.7 million in the 2020 Nebraska Tax Expenditure Report.[20]

Low-Income Families

While not tied to the use of paid child care, low-income families in Nebraska can receive:

- A refundable tax credit equal to 10% of the federal earned income tax credit,[21] and
- A nonrefundable credit of $140 (for 2020) for every personal exemption, which is authorized for all Nebraska residents (not restricted to low-income individuals).[22]

Both of these tax credits support families in meeting household expenses. However, they are not specifically designed to help with child care costs. This is an important distinction because not all families may pay for child care. Therefore, families who pay for child care have additional costs beyond typical monthly expenses such as rent, utilities, food, etc.

Child care tax incentives throughout the U.S.

The tax code is used by states as one way to spur investment in child care (e.g., to expand the supply of child care, to improve the quality of child care or to make child care more affordable for families).

Because tax incentives have different public policy purposes, some states have multiple types of tax incentives to address the child care market. For example, Colorado has five different types of employer child care tax incentives plus a tax credit for families based on the use of paid child care.[23]

Across states, there are eight broad categories of employer-related tax incentives for child care.[24]

Broad Categories of Child Care Incentives

- **Employer-sponsored child care tax credits**: A tax credit for operating child care onsite or contracting within the community for child care for employees.
- **Child care contribution tax credits**: A tax credit for contributions made to individual child care programs or to a state pool that distributes funds to child care providers.
- **Child care workforce tax credits**: A tax credit tied to professional development—certifications and level of education attained by the workforce.
- **Child care wage tax credits**: A tax credit tied to annual child care wages.
- **Child care property tax exemptions**: A property tax exemption for child care programs.
- **Child care subsidy tax credits**: A tax credit tied to the number of children whose care is paid for with a child care subsidy.
- **Child care tax credits tied to state pre-kindergarten programs**: A tax credit to support communities to expand access to state pre-k within child care programs—mixed delivery pre-k systems.

Note: Nebraska has two child care tax credits—one related to the child care workforce to incent professional development and increase wages and the other to incent child care programs to serve children whose care is paid for with a child care subsidy.

Source: Committee for Economic Development of The Conference Board, State Tax Credits for Child Care, November 2020. https://www.ced.org/child-care-state-tax-credits

Each type of tax credit is aligned with a specific goal. For example, 15 states have 22 different types of employer-sponsored child care tax credits.[25]

These incentives range from a tax credit for operating onsite child care or contracting within the community for child care for employees to costs related to planning, site preparation, construction, renovation or acquisition of property or materials related to provision of child care for employees. These state credits are in addition to, or "piggyback," on a federal tax credit for employers related to provision of onsite child care or contracting within communities for child care.[26]

The challenge for states with piggyback provisions related to the federal employer child care tax credit is that the federal credit was created as part of the Economic Growth & Tax Relief Reconciliation Act of 2001 (P.L. 107-16) and has not been adjusted in nearly 20 years—despite that costs related to providing child care have greatly increased over the past two decades.

The child care contribution tax credit

Colorado and Oregon have child care contribution tax credits. They are structured differently, but the overall concept of the child care contribution credit is to spur charitable donations to better support the child care market.

Colorado's tax code offers a 50% credit up to a maximum annual credit of $100,000 per taxpayer.[27] Donations are made to individual programs and must be made in cash. The credit is available far beyond the child care field (e.g., credits can also be issued for donations to support foster care homes, youth shelters, residential child care facilities, child placement agencies, etc.).[28]

Donations can be used for a wide variety of purposes from establishing and operating a program to training for staff or information and referral services for parents.

There is no cap on the overall annual level of tax credits that can be issued. For 2017, the Colorado Department of Revenue estimated:[29]

- 70 corporations utilized the credit at a cost of $566,810, and
- 18,414 individuals utilized the credit at a cost of $28.8 million.

The Oregon contribution tax credit is also restricted to 50% of taxpayer donations. However, the overall issuance of tax credits is capped at $500,000 annually.[30] Unlike the Colorado tax credit that is based on donations to individual programs, the Oregon tax credit supports donations to the Oregon Office of Child Care within the Department of Education.[31]

The Office of Child Care uses the donations to support two programs:

- An education award program used to increase wages paired with professional development achievements for the child care workforce, and
- A quality improvement program to allocate grants to licensed programs that participate in the Oregon quality rating and improvement system, Spark.

Several factors impact the cost (and effectiveness) of the Oregon tax credit. The overall cap on annual tax credits may limit the incentive for donations (e.g., one large donor could crowd out others who may have considered contributing more modestly). Also, in 2015, the Oregon State Legislature limited tax credits to 50% of contributions[32] (potentially to reduce the crowd-out impact against the annual cap). However, the overall result was a reduction in both the number of taxpayers who donated and the level of donations.

In 2016, the Oregon Department of Revenue reported that about 10 taxpayers shared the $500,000 in tax credits available.[33] In 2017, donations declined to $53,000.[34]

Both the Colorado and Oregon tax credits are not refundable, but credits can be carried forward in future years. More information about both credits is available in the Appendix.

While not called a child care contribution credit specifically, such as the Colorado and Oregon tax credits, the package of tax credits in Louisiana referred to collectively as the *school readiness tax credit* has a component that allows for a refundable tax credit for business contributions to both child care programs and child care resource and referral agencies.[35]

The Louisiana Department of Revenue estimated the cost of such donations by employers at $423,703 for fiscal year 2019.[36] None of the components of the Louisiana school readiness tax credits are capped on an annual basis.

Many variables impact the cost of a tax credit beyond how it is structured (i.e., beyond allowable donation recipients and allowable uses for donations), such as the overall visibility or marketing of a tax credit (i.e., public awareness), the pool of taxpayers (individuals or corporations) that may have a desire or need to make contributions, whether a tax credit is refundable or must be carried forward as well as whether there is any type of cap on overall contributions.

Using tax credits to address child care supply shortages

The 15 states that have some type of employer child care tax credit, which utilize 22 different strategies addressing supply challenges,[37] are difficult to quantify related to the number of businesses claiming the credit as well as the overall cost.

The primary reason is that while all states have some type of tax expenditure report (i.e., a report related to the cost of tax incentives),[38] not all states provide detail about every tax incentive. Some state tax expenditure reports share information related to the number of beneficiaries that utilize tax preferences and some do not.[39] Also, no detail is publicly available through the state tax expenditure reports related to specific child care strategies (e.g., to increase the supply of home-based child care vs. child care centers) or the geographic distribution of child care tax incentives.

Unlike states with inconsistent public disclosure of tax incentive data, Nebraska is required by state statute to produce an annual tax incentive report.[40] This report details the number

Currently, about 15 states offer some type of tax credit to employers who are invested in efforts to promote access to child care for their workforce. Nevertheless, it can be difficult to gauge the degree to which these tax credits are actively being used.

of tax incentive beneficiaries, specific amounts related to tax incentives, as well as the identity of the companies in many cases and the geography or location of tax incentive projects.

It could be that the current child care tax credit for child care providers who serve children on subsidy is not reported publicly for confidentiality reasons related to subsidy receipt.

In addressing the supply shortage of child care, it is important to identify:

- The geographic area where there is a child care shortage (to avoid a tax incentive to overbuild in an already saturated market);
- The type of child care to incent within communities (e.g., rural areas may need more home-based care rather than center-based programs where the density of the population may not support the economic viability of operating a center);
- The preferences of parents to the extent possible (e.g., home-based or center-based care, care near work or home or other variables such as the need for nontraditional hour care or care for children with special needs).

The Nebraska Early Childhood Workforce Commission estimated that fully funding early care and education would require an additional investment of $452.3 million.[41] Using the tax code to incentivize public-private partnerships (which is what tax incentives drive) is one strategy to help fill some of that gap.

Beyond the types of tax credits currently used by states, it may be of interest to explore modifying a current state tax credit to meet multiple purposes.

For example, the Nebraska Affordable Housing Tax Credit,[42] modeled after the federal low-income housing tax credit,[43] could offer an opportunity to increase the amount of the tax credit as well as make it refundable if such projects serving families with children also include a child care facility on the premises.

The Nebraska Department of Revenue estimates the cost of the current affordable housing tax credit (AHTC) at $1.5 million for 2019.[44]

Tax Incentive Recommendations

There is no off-the-shelf model to adopt. Each tax credit needs to be aligned with a specific goal within the unique state and local context, be robust enough to entice investment and be crafted in a way that supports both urban and rural communities.

As with direct spending programs, there is no quick fix and no single approach that will resolve quality child care supply and affordability challenges. However, tax incentive strategies can be used as one of several ways to attract investment to help meet community needs.

Appendix: The Child Care Contribution Tax Credit

Colorado[45]

Basics: Taxpayers (individuals, corporations, trusts, estates and partnerships) can claim a tax credit of 50% of their contribution up to a maximum credit of $100,000. Donations are made directly to child care programs or qualifying facilities.

Types of donations allowed: Cash (not stock)

Allowable purposes of the donation:

- Establishment or operation of a licensed child care program serving children age 12 or younger
- A grant or loan program for parents requiring financial assistance for child care
- A training program for child care providers
- An information dissemination program for child care provider information and referral services to assist parents in selecting child care

Qualifying Child Care Facilities or Programs:

- Licensed child care centers
- Child placement agencies
- Family child care homes
- Foster care homes
- Homeless youth shelters
- Residential child care facilities
- Secure residential treatment centers
- Any facility school that is affiliated with a licensed or certified hospital in Colorado and is also a nonprofit organization
- Unlicensed child care facilities that provide child care for five or more children who are not related to the owner, operator or manager (i.e., that are registered with the Colorado Department of Revenue and explain why licensing is not required)

Prohibitions/Contributions that do not qualify:

- Contributions cannot be made to a child care facility in which the taxpayer or a person related to the taxpayer has a financial interest
- Contributions cannot be made to a for-profit child care business unless the contribution is used for acquisition or improvement of facilities, equipment or services including improvement of staff salaries, staff training or the quality of child care
- The donor cannot receive consideration from the donee program in exchange for the contribution. However, if a company makes a donation and the employees of the company receive a benefit in the form of discounted child care, then the contribution is allowable as long as the employer has no financial interest in the child care program.
- Contributions to school-based programs maintained during regular school hours (including kindergarten and preschool)

Carryforward: The credit is not refundable, but can be carried forward for up to five tax years.

Credit Expiration: December 31, 2024

Usage & Cost:[46] For 2017, the Colorado Department of Revenue estimated:

- 70 corporations utilized the credit for a cost of $566,810
- 18,414 individuals utilized the credit for a cost of $28.8 million

Oregon[47]

Basics: Taxpayers (individuals, corporations, trusts, estates and partnerships) can claim a tax credit of 50% of their contribution. The overall distribution of tax credits is capped at $500,000 per year. Donations are made to the Oregon Office of Child Care within the Department of Education, not to individual child care programs.

Types of donations allowed: Cash or stock

Allowable purposes of the donation: Donations received through the Child Care Contribution Tax Credit are used to support two programs:

- An education award program that allocates $100-$500 annually for individuals or supervisors providing direct care to children under age 13 for at least 20 hours per week who have achieved a step 3 or higher on the Oregon Early Care and Education Registry, and
- Quality improvement grants to licensed child care programs participating in Spark, the Oregon quality rating and improvement system.

Carryforward: The credit is not refundable, but can be carried forward for up to four tax years.

Credit Expiration: December 31, 2021

Usage & Cost:[48] For 2016, the Oregon Department of Revenue reported that about 10 taxpayers contributed a total of $1 million to the Office of Child Care with a total value of $500,000 in tax credit certificates. For 2017, about 10 taxpayers contributed a total of about $53,000 to the Office of Child Care with a total value of about $27,000 in tax credit certificates. Most contributions are from individual taxpayers.

Note: In 2015, the Oregon State Legislature restricted the value of the tax credit from 100% of the contribution to 50%. While tax year 2016 received $1 million in contributions to maximize the credit use, it was due to primarily one large contribution. There was a significant decline in tax year 2017 to $53,000. For the two tax years prior to the change of the credit in 2015, the contributions averaged over $600,000 per year.

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