DEPARTMENT OF TAXATION
2014 Fiscal Impact Statement

1. Patron Christopher K. Peace

2. Bill Number HB 1047

House of Origin:
X **Introduced**
_____ **Substitute**
_____ **Engrossed**

Second House:
_____ **In Committee**
_____ **Substitute**
_____ **Enrolled**

3. Committee House Finance

4. Title Individual Income Tax; Working Family Child Tax Credit

5. Summary/Purpose:

This bill would allow a parent or legal guardian to claim a credit against the individual income tax for eligible child-care expenses paid during the taxable year. The amount of the credit would equal $100 per eligible child, not to exceed $300 for the taxable year for any parent or legal guardian. No credit would be allowed to any single individual whose Virginia adjusted gross income ("VAGI") for the taxable year is in excess of $65,000 or to married individuals with VAGI in excess of $90,000 for the taxable year. In addition, no credit would be allowed for any child that has not been enrolled for at least eleven months in a child-care program participating in the Virginia Star Quality Initiative, which program is required to achieve at least a Star 1-level rating from the Virginia Star Quality Initiative for such time period. The amount of the credit claimed by any parent or legal guardian would be limited to the income tax liability imposed upon such individual for the taxable year.

This bill would be effective for taxable years beginning on or after January 1, 2015.

6. Budget amendment necessary: Yes.
ITEM(S): Page 1, Revenue Estimates

7. Fiscal Impact Estimates are: Tentative. (See Line 8).
7b. Revenue Impact:

Fiscal Year	***Dollars***	***Fund***
2013-14	$0	GF
2014-15	$0	GF
2015-16	($770,000)	GF
2016-17	($770,000)	GF
2017-18	($770,000)	GF
2018-19	($770,000)	GF
2019-20	($770,000)	GF

8. Fiscal implications:

Administrative Costs

The Department of Taxation ("the Department") has not assigned any administrative costs to this bill because the changes required by a single bill such as this can be implemented as part of the annual changes to our systems and forms. As stand-alone legislation, the Department considers implementation of this bill as "routine," and does not require additional funding.

The Department will provide specific administrative costs on any legislation that is not "routine." Additionally, the Department will review all state tax legislation likely to be enacted prior to the passage by each house. If the aggregate number of routine bills likely to pass either house is unusually large, it is possible that additional resources will be required. If so, the Department will identify the costs at that time.

Revenue Impact

This bill would have an estimated annual negative revenue impact of $770,000, beginning in Fiscal Year 2016. This estimate is based on the average number of tax returns upon which the child care expenses deduction was claimed during Taxable Years 2008 through 2011, adjusted to meet the income, age, and licensure requirements of this bill.

During Taxable Years 2008 through 2011, an average of 191,212 returns included a deduction for child care expenses. According to U.S. census data, there is an average of 1.77 children in each family that has children. If this average is applied to the average number of returns upon which a deduction for child care expenses was claimed, it is estimated that the child care expenses deduction is being claimed for an average of 338,445 children. The Department determined the percentage of married and single filers claiming the deduction and applied the $90,000 and $65,000 filing thresholds to these taxpayers respectively.

According to a report on the Virginia Star Quality Initiative prepared by the Office of Planning, Research and Evaluation, approximately ten percent of licensed facilities in Virginia have achieved at least a Star 1-level rating from the Virginia Star Quality Initiative. Based on this statistic and the assumption that one-third of children are age six or below, the Department estimates that approximately 7,698 children have expenses that would qualify for the program. If the maximum amount of credit is claimed by the parents of such children, this tax credit program would have an impact of approximately $770,000.

9. Specific agency or political subdivisions affected:

Department of Taxation

10. Technical amendment necessary: No.

11. Other comments:

Federal Child Tax Credit

Under federal law, a taxpayer may claim a $1,000 child tax credit against the individual income tax for each qualifying child for whom the taxpayer is allowed a dependency deduction. For purposes of the child tax credit, the term “qualifying child” is defined the same as that for claiming a dependency exemption except that the child must not have attained age 17 by the end of the taxable year. Generally, a “qualifying child” is the taxpayer’s child, stepchild, adopted child, eligible foster child, sibling, step sibling, or a descendant of any such individual, who lives with the taxpayer for more than half of the taxable year and does not provide more than half of his own support.

For taxpayers with modified adjusted gross income (“MAGI”) above certain thresholds, the otherwise allowable child tax credit is phased out. Specifically, the amount of the credit is reduced by $50 for each $1,000, or fraction thereof, by which the taxpayer’s MAGI exceeds the applicable threshold amount. The threshold amounts are as follows: $110,000 for married taxpayers filing a joint return, $55,000 for married taxpayers filing separate returns, and $75,000 for single taxpayers.

Federal Credit for Child and Dependent Care Expenses

Under federal law, a nonrefundable credit is allowed for a portion of qualifying child and dependent care expenses paid for the purpose of allowing the taxpayer to be gainfully employed. To be eligible for the credit, the taxpayer must incur employment-related expenses in providing care for one or more qualified individuals.

For purposes of this credit, the term “qualifying individual” means a dependent of the taxpayer who has not attained age 13; a dependent of the taxpayer who is physically or mentally incapable of caring for himself or herself and who has the same principal place of abode as the taxpayer for more than half of the taxable year; or the taxpayer’s spouse, if the spouse is incapable of caring for himself or herself and has the same principal place of abode as the taxpayer for more than half of the taxable year.

Qualifying employment-related expenses include expenses paid for household services and for the care of a qualifying individual that allow the taxpayer to work or look for work. Services rendered outside the home qualify if they involve the care of a qualified individual who regularly spends at least eight hours per day in the taxpayer’s home.

The maximum amount of employment-related expenses to which the credit may be applied is $3,000 for one qualifying individual or $6,000 for two or more qualifying individuals, less the amount excludable by the taxpayer for any employer-provided dependent care assistance. The amount of the credit is equal to the amount of qualified expenses multiplied by the applicable percentage, as determined by the taxpayer’s adjusted gross income (“AGI”). Taxpayer’s with an AGI of $15,000 or less use the highest applicable percentage of 35 percent. For taxpayer’s with an AGI over $15,000, the credit is reduced by one percentage point for each $2,000 of AGI, or fraction thereof, in excess of $15,000. The minimum applicable percentage of 20 percent is used by taxpayers with an AGI greater than $43,000. Thus, the maximum dependent care credit amount is $1,050 for one qualifying individual and $2,100 for two or more qualifying individuals.

Qualifying employment-related expenses are considered in determining the credit only to the extent of earned income. For married taxpayers, expenses are limited to the earned income of the lower-earning spouse. Generally, if one spouse is not working, no credit is allowed. However, if the nonworking spouse if physically ill or mentally incapable of caring for himself or herself or is a full-time student at an educational institution for at least five calendar months during the year, the law imputes an earned income amount, for each month of disability or school attendance, of $250 if there is one qualifying individual or of $500 if there is two or more qualifying individuals.

<u>Virginia Deduction for Child and Dependent Care Expenses</u>

In Virginia, taxpayers may deduct the amount of employment-related expenses on which the federal child and dependent care credit is based. The amount of employment-related expenses that may be deducted is limited to the amount actually used in computing the federal child and dependent care credit. As a general rule, taxpayers are limited to a maximum deduction of $3,000 for one child and $6,000 for two or more dependents, or the earned income of the spouse having the lowest income, whichever is less.

<u>Virginia Star Quality Initiative</u>

The Virginia Star Quality Initiative ("VSQI") is a partnership between the Office of Early Childhood Development, a division of the Virginia Department of Social Services, and the Virginia Early Childhood Foundation that was created to provide a consistent way to distinguish the level of quality in early care and education programs, allowing parents to make more informed choices when selecting child care.

Program participation in VSQI is voluntary. All early childhood programs, including Virginia Preschool Initiative classrooms, private and faith-based centers, for-profit centers, nonprofit centers, and Head Start programs, are eligible to apply. Participating programs are evaluated once every two years by a Star Quality Rater. One, two, three, four, or five stars are awarded to programs based on achievement in four quality standards. Any program that receives one star or more reflects a program with a commitment to quality.

<u>Proposed Legislation</u>

This bill would allow a parent or legal guardian to claim a credit against the individual income tax for eligible child-care expenses paid during the taxable year. The amount of the credit would equal $100 per eligible child, not to exceed $300 for the taxable year for any parent or legal guardian. No credit would be allowed to any single individual whose Virginia adjusted gross income ("VAGI") for the taxable year is in excess of $65,000 or to married individuals with VAGI in excess of $90,000 for the taxable year. In addition, no credit would be allowed for any child that has not been enrolled for at least eleven months in a child-care program participating in the Virginia Star Quality Initiative, which program is required to achieve at least a Star 1-level rating from the Virginia Star Quality Initiative for such time period. The amount of the credit claimed by any parent or legal guardian would be limited to the income tax liability imposed upon such individual for the taxable year.

For purposes of this bill, the term “child-care program” would be defined as a regularly operating service arrangement for children where, during the absence of a parent or guardian, a person or organization has agreed to assume responsibility for the supervision, protection, and well-being of a child for less than a twenty-four hour period.

The term “eligible child-care expenses” would be defined as amounts charged by a child-care program participating in the Virginia Star Quality Initiative for the enrollment in the program of a child age six years or younger.

“Virginia Star Quality Initiative” would mean a quality rating and improvement system for child-care programs administered through a public-private partnership that includes the Office of Early Childhood Development of the Department of Social Services.

The Department would be required to develop guidelines implementing the provisions of this bill. Such guidelines would be exempt from the Administrative Process Act.

This bill would not prohibit taxpayers from claiming this credit in addition to the existing federal credit and Virginia deduction for child and dependent care expenses.

This bill would be effective for taxable years beginning on or after January 1, 2015.

cc : Secretary of Finance

Date: 01/30/2014 mjm
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