DEPARTMENT OF TAXATION
2021 Fiscal Impact Statement

1. Patron Jason S. Miyares

2. Bill Number HB 2142

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

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

3. Committee House Finance

4. Title Individual Income Tax; Child Care Tax Credit

5. Summary/Purpose:

This bill would provide an individual income tax credit for Taxable Year 2020 and Taxable Year 2021 in an amount equal to the lesser of $1,000 or the actual amount of eligible child care expenses incurred and paid by the taxpayer. "Eligible child-care expense" would be defined as additional amounts incurred and paid by the taxpayer for child care that are:

- Not child care expenses regularly incurred prior to the coronavirus disease 2019 ("COVID-19") pandemic;

- Verified pursuant to guidelines issued by the Department of Taxation ("the Department"); and

- Incurred only due to closures of the taxpayer's child's day care facility or primary or secondary school as a result of the COVID-19 pandemic between September 1, 2020 and July 1, 2021. The credit would not be subject to an annual credit cap.

This bill would be effective for taxable years beginning on and after January 1, 2020, but before January 1, 2022.

6. Budget amendment necessary: Yes.
Item(s): Page 1, Revenue Estimates
282 and 284, Department of Taxation

7. Fiscal Impact Estimates are: Preliminary. (See Line 8.)
7a. Expenditure Impact:

Fiscal Year	***Dollars***	***Positions***	***Fund***
2021-22	$212,037	0	GF
2022-23	Routine	0	GF
2023-24	Routine	0	GF
2024-25	Routine	0	GF
2025-26	Routine	0	GF

8. Fiscal implications:

Administrative Costs

Due to the timing of this legislation, it would not be feasible to add the proposed tax credit to the Taxable Year 2020 return (see Line 11 below). Accordingly, the administrative cost analysis published in this fiscal impact statement is based on the assumption that the credit this bill would provide would be available solely on Taxable Year 2021 income tax returns.

Adding the proposed tax credit to the Taxable Year 2021 return would result in administrative costs to the Department of $212,037 in Fiscal Year 2022. Such costs would include expenses to update the Department's forms and systems to implement the credit this bill would provide. Any costs thereafter would be considered routine.

Revenue Impact

This bill would have an unknown, but potentially significant, negative General Fund revenue impact in Fiscal Year 2022. It is unknown to what extent the COVID-19 pandemic has resulted in taxpayers incurring increased child care expenses that would be eligible for this credit. As a result of the COVID-19 pandemic, public school enrollment has decreased by more than 45,000 students when compared to the 2019-2020 school year. It is likely this has and will continue to result in a significant increase in expenses related to child care. If the maximum credit was claimed for expenses related to each of these students, it could result in an impact of $45 million annually. However, this does not take into account private childcare closures or expenses paid for tutoring or nannies to assist with virtual learning for students still enrolled in public schools, so the actual impact could be greater.

9. Specific agency or political subdivisions affected:

Department of Taxation

10. Technical amendment necessary: Yes. As currently drafted, the proposed tax credit would be effective for Taxable Year 2020 and Taxable Year 2021. The filing season for Taxable Year 2020 will already be underway by the time this bill passes and, since the bill does not contain an emergency clause, it would not become effective until July 1, after the filing deadline for most individuals. For these reasons, it is not feasible to program the Department's systems to accommodate a new tax credit on the Taxable Year 2020 return. Therefore, the Department recommends a technical amendment that would provide this credit solely for Taxable Year 2021. If the Patron desires, the bill could allow eligible expenses incurred during Taxable Year 2020 to be included for purposes of computing the Taxable Year 2021 credit.

11. Other comments:

Federal Credit for Child and Dependent Care Expenses

Under federal law, a nonrefundable credit is allowed for a portion of qualifying household 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 qualifying child 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 AGI. Taxpayers with an AGI of $15,000 or less use the highest applicable percentage of 35 percent. For taxpayers 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 is 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 $500 if there are two or more qualifying individuals.

Federal Dependent Care Flexible Spending Account

For federal income tax purposes, employees may exclude certain dependent care benefits from income through a dependent care flexible spending account ("dependent care FSA"). A dependent care FSA is a pre-tax benefit account used to pay for eligible dependent care services, such as preschool, summer day camp, before or after school programs, and child or adult daycare. With a dependent care FSA, taxpayers can use pretax dollars to pay qualified out-of-pocket dependent care expenses.

In order to qualify for a dependent care FSA, a child must be under age 13 and expenses must be for before and after school care, babysitting and nanny expenses, daycare, nursery and preschool, or summer day camp. A dependent care FSA can also be used for care for a spouse or a relative who is physically or mentally incapable of self-care and lives in the taxpayer's home. The maximum contribution for a dependent care FSA is $5,000 per year or $2,500 per year for married taxpayers who file separate tax returns.

Virginia Deduction for Child and Dependent Care Expenses

In Virginia, taxpayers may deduct the amount of employment-related expenses upon 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. 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.

Proposed Legislation

This bill would provide an individual income tax credit for Taxable Year 2020 and Taxable Year 2021 in an amount equal to the lesser of $1,000 or the actual amount of eligible child care expenses incurred and paid by the taxpayer. "Eligible child care expense" would be defined as amounts incurred and paid by the taxpayer for child care that are:

- Not child care expenses regularly incurred prior to the COVID-19 pandemic;
- Verified pursuant to the Department's guidelines; and
- Incurred only due to closures of the taxpayer's child's day care facility or primary or secondary school as a result of the COVID-19 pandemic between September 1, 2020 and July 1, 2021.

If two parents of the same child file separately, only one of the two parents would be permitted to claim the credit. The credit would not be subject to an annual credit cap.

No taxpayer would be permitted to claim the credit that this bill would provide and the Virginia deduction for employment-related expenses that are used for purposes of computing the federal credit for expenses for household and dependent care services necessary for gainful employment.

The amount of the credit that may be claimed would be limited to the taxpayer's income tax liability for the taxable year. If the amount of credits exceeds the taxpayer's income tax liability for the taxable year in which the child care expenses were incurred, the taxpayer would be allowed to carry over the excess amount of credit against their income taxes for the next five taxable years or until the total amount of the credit has been taken, whichever occurs first.

This bill would require the Tax Commissioner to develop guidelines, exempt from the Administrative Process Act, for claiming the credit.

This bill would be effective for Taxable Years beginning on and after January 1, 2020, but before January 1, 2022.

cc : Secretary of Finance

Date: 1/29/2021 JLOF
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