ZEROTOFIVE MONTANA

June 2, 2022
www.zerotofive.org

# TAX INCENTIVES FOR CHILD CARE FACILITIES & BUSINESS DEVELOPMENT

Tax credits and incentives are an approach to reduce the cost of child care, and support employers who are providing child care as part of their business model. An increasing number of states are implementing policy strategies to support businesses that offer child care benefits to their employees. States also recognize tax credits and incentives do not fully address the systemic funding challenge associated with child care in our country, but see these efforts as having some positive impact in workforce retention.

The following policy brief outlines a variety of child care tax incentive programs across the country that may be applicable to policy analysis and planning in Montana.

## BACKGROUND

Currently, eighteen states, as well as the federal government, offer tax incentives for businesses to help employees access or afford child care. Tax incentives (tax credits, deductions, and exemptions) are available for child care facilities, child care referrals, child care operations, employer-sponsored child care (either on-site or contracted within the community), and to encourage professional development and increase wages for the child care workforce. These tax incentives are available at varying degrees and can serve a few purposes in improving access to child care, including enhancing quality, increasing supply, encouraging private investments, supplementing existing state funds, and supporting child care workers (e.g., some states have refundable tax credits linked to early childhood education).

Child care tax incentives are not a panacea but can play a valuable role in helping to address state and local child care challenges. As with any policy, child care tax credits come with their own set of opportunities and challenges. A report by the North Carolina Early Childhood Foundation notes the pros and cons of using the tax code to address child care policy issues. For example, tax credits can supplement existing resources, but may be insufficient (depending on how they are structured) to promote systemic change on their own. Tax policy can be perceived as an investment or incentive for investment, but may be difficult to distribute equitably across the state, depending on how the credits are drafted and whether they are enough of an incentive to spur acquisition, construction, and the operation of child care programs. Tax credits are an important incentive for both investing in a social good and enabling investors to realize an economic benefit (i.e., reduce taxes otherwise owed). However, businesses without tax liability have few reasons to use tax credits.

Other strategies, such as family/child tax credits and child care subsidy expansion, are additional actions to address child care affordability, but will not be discussed in this brief. Notably, some tax incentives for businesses, including those focusing on workforce development, do seem to have an impact on child care quality, particularly when the tax benefit and a state Quality Rating Improvement System (QRIS) are linked.

The remainder of this brief explores states that offer tax credits to employers or those working in child care, alongside some policy options that have been proposed by various state and local jurisdictions.

## FEDERAL INCENTIVES: SUMMARY OF WHAT CURRENTLY EXISTS

At the federal level, the 45F investment tax credit is available to support employers who provide child care options for employees. The incentive provides employers a credit of up to 25% of qualified child care expenditures and 10% of qualified child care resource and referral expenditures. The credit is capped at $150,000 per year.

Qualified expenditures include both investment in child care facilities, as well as supporting ongoing operating costs. Child care worker training and wages are included. Employers can provide on-site child care or contract with existing, licensed child care providers (including in-home providers). For the child care resource and referral expenditures, employers can claim a credit for amounts paid to help employees find child care, so long as the benefit is available to all employees.

A Government Accountability Office analysis of the credit, released in February 2022, indicated that the impact of the credit has been minimal due to a variety of factors including lack of employer awareness, the credit being too small to be useful, lack of child care options for certain classes of employees, and total cost of child care for employees. Small business owners may particularly struggle to use the 45F tax credit. Larger businesses are more likely to be able to make the scale of expenditure necessary to claim the full credit and to have resources to fill the unfunded gaps. A June 2021 report from the Bipartisan Policy Center highlighted Patagonia as an example – the company receives the full investment tax credit of $150,000 per year, but still spends more than $1 million annually to provide child care to all of its employees. Most start-up child care facilities would be unable to spend at the level to receive the maximum benefit, and a smaller benefit may ultimately not impact investment.

Employers may also establish a Dependent Care Assistance Program (DCAP), similar to a healthcare FSA, to allow employees to set aside up to $5,000 in pretax earnings for qualified child care expenses. Employers may benefit from such a program by a reduction in payroll taxes. As part of the American Rescue Plan Act of 2021, DCAPs were increased to $10,500 for 2021 taxes.

## STATE INCENTIVES

Multiple states offer income tax credits to employers who offer child care to employees or provide child care assistance to employees. The amounts of credits vary, as does the eligibility. Some states and localities have also experimented with issuing bonds to create loan programs, as well as other incentives for child care facilities.

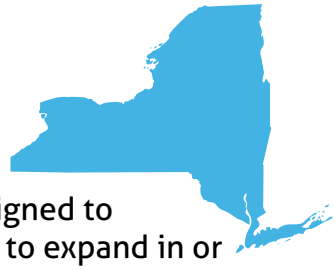
### MONTANA

Montana previously offered incentives to employers similar to the federal 45F investment tax credit, but those provisions were repealed during the 2021 legislative session. Montana had also offered a facilities tax credit, capped at $50,000, but that was also repealed in 2021. *In Montana, 60% of residents live in a child care desert.*

### NEW MEXICO

In 2020, New Mexico appropriated $300 million into an endowment fund, called the Early Childhood Education and Care Fund. The endowment will receive oil and gas revenues in the future. The fund supports a wide variety of programs, including child care, preschool, and maternal-infant health. I*n New Mexico, 53% of the population lives in a child care desert.*

## NEW YORK



In 2021, the state of New York expanded its Excelsior Jobs program, which is designed to encourage businesses to expand in or relocate to New York. The framework offers several tax incentives for business growth, including a credit for up to 6% of net new child care services expenditures for the operation, sponsorship or direct financial support of a child care services program, as well as a 5% credit for costs associated with child care facilities.

New York also offers a credit for employer-sponsored/contracted child care at 200% of 45F with a limit of $500,000.

*Currently, approximately 64% of New York families live in a child care desert.*

## LOUISIANA

Louisiana has a comprehensive incentive structure, which pairs provider-focused and family-focused tax credits, with the primary purpose of encouraging participation in the state's QRIS. Families can receive an income tax credit that increases based on the star-rating of a facility. Child care businesses receive a tax credit for each child whose care is paid for with a child care subsidy or in foster care who is enrolled in their program, depending on the star-rating of the facility. Child care staff are eligible for a refundable income tax credit, based on their participation in a professional development system, while businesses can get a similar credit against individual or corporate tax for supporting a child care or a resource and referral program.

*Despite this robust system, 42% of Louisiana residents live in a child care desert.*

## GEORGIA

Georgia offers employers who purchase property for child care facilities a 100% tax credit (10% per year over 10 years) for costs related to land acquisition, improvements, buildings, building improvements, furniture and equipment used for the construction, expansion, improvement or operation of an employer provided child care program.

The child care program must be licensed, and at least 95% of the children enrolled must be children of the employees (multiple businesses may collaborate). The property must remain in service for 14 years as a child care facility.

*In Georgia, 44% of families live in a child care desert.*

## MAINE

The state of Maine *has the lowest percentage of families living in a child care desert at 22%*, but currently has a limited set of tax incentives. Providers who spend more than $10,000 per year to improve the quality of the program may take a $1,000 tax credit for the next 10 years and a second $10,000 credit in the tenth year. Facilities structured as a corporation may receive a 30% investment tax credit. Neither credit is refundable. Families can also receive an individual credit for child care costs, in addition to the federal credit.

During the 2022 Legislative session, Maine considered a tax package similar to Louisiana's, but the bill died on May 9 with the adjournment of the legislative session.

## NEBRASKA

Although Nebraska's School Readiness Tax Credit has since expired, child care and early education providers were eligible for the credit if they served children receiving a child care subsidy. As the quality rating of the program increased, so did the tax credit. An early childhood workforce tax credit was also available to eligible staff members, increasing as early childhood competencies increased (e.g., earning a Child Development Associate [CDA] credential, an A.A. or B.A. in early childhood). The credit was available from tax years after January 2017 and before January 2022. Advocates want to restore the credit in the upcoming legislative session.

*In Nebraska, 28% of residents live in a child care desert, though availability remains limited in rural parts of the state.*

## ARKANSAS

The state of Arkansas provides a few tax credits directly related to employers. Businesses that provide child care to employees can qualify for a credit of 3.9% of the salary of employees who work to provide child care services.

Additionally, a credit of the same amount exists for business that provide child care directly to its employees, or a $5,000 income tax credit for the first year the employer provides child care. A business which operates or contracts child care is also eligible for an employer-sponsored child care credit to cover the cost of initial construction and outfitting of the facility for qualified early childhood programs and/or licensed child care services.

*In Arkansas, 35% of residents live in a child care desert. Rural parts of Arkansas are more likely to experience limited child care.*

## ILLINOIS

Through the Illinois Employee Child Care Assistance Program Tax Credit, businesses that provide child care for employees can recover 30% of their start-up costs and 5% of the annual amount to provide the service. To be eligible for the tax credit, businesses must provide and operate the child care program or work with other businesses to provide and operate the child care facility. Illinois also offers a Dependent Care Assistance Tax Credit to employers working in manufacturing that offer a dependent care assistance program in the form of on-site child care. The credit is determined by the fair market value of dependent care assistance in the form of on-site care, such as the cost of food, transportation, and staff.

*In Illinois, 58% of residents live in a child care desert.*

## MISSISSIPPI

In the state of Mississippi, a 50% tax credit is available to employers that provide child care to employees during work hours. Employers can use the credit towards costs to provide child care, including staff, materials, and more. Alternatively, employers may also use the credit to cover the cost of contracting with an outside individual or business to provide child care for employees.

Beginning in 2013, those who contribute to a qualified preschool program are also eligible for a tax credit up to $1 million if the contribution supports a program's local match requirement.

*At present, 48% of people in Mississippi live in a child care desert.*

## COLORADO

Colorado's Child Care Contribution Tax Credit allows any taxpayer to make financial contributions to support child care in Colorado and claim 50% of the contribution, up to $100,000. Employers are also able to invest in property to be used as a child care facility, alongside a credit which encourages employers to provide child care services or help employees offset their costs of child care, but only if the children of those employees are receiving public assistance. Like a few other states, Colorado has an early childhood workforce credit known as the Early Educator Tax Credit, which provides a credit to early childhood professionals, that increases as early childhood competencies increase.

Additionally, a credit in Colorado allows property used for charitable purposes to avoid levies and property tax obligations if it is used as primarily as a child care center.

*Currently, 51% of people in Colorado live in a child care desert.*

## SOUTH CAROLINA

In South Carolina, a tax credit is available for employee child care programs. Employers may claim 50% of the costs associated with establishing and operating a child care for its employees' children, up to $100,000. The credit can also be used by employers who make donations to nonprofits to establish a child care program, as well as employers who directly pay a licensed child care facility to provide child care as a benefit to their employees.

*Across South Carolina, 42% of people live in a child care desert.*

## VIRGINIA

In Virginia, there is only one tax credit specifically for employer-provided child care. The Day Care Facility Investment Tax Credit allows employers to claim 25% of the costs to construct, renovate, acquire, or otherwise establish a child care facility to provide child care to its employees' children. The amount of this particular credit cannot exceed $25,000. Virginia's employer tax credit is only for establishing, not operating, a child care facility.

*In Virginia, 47% of people live in a child care desert. In rural areas, 63% of residents live in child care deserts.*

## CONCLUSION

States across the country use tax incentives to increase the availability of child care, enhance quality, and support professional development and wages among the child care workforce. Though there are many ways to offer tax incentives, the scale of potential incentives may influence usage and participation. While tax incentives create many opportunities, states should still assess and plan for possible challenges. When offered at effective amounts and implemented constructively, tax incentives may help address the child care needs of states and localities.

In the following pages, a few specific recommendations and considerations are outlined for Montana, as well as some general policy proposals for funding early care and education.

## SPECIFIC RECOMMENDATIONS AND CONSIDERATIONS FOR MONTANA

### *Using Tax Credits to Solve Child Care Issues*

Tax credits can spur investment to address the supply of child care, help reduce the cost for parents, or help improve quality. Like grant programs, they are not a cure-all, but can play an important role in policy approaches to address market concerns. Regardless, tax incentives create an opportunity to increase overall quality of child care and may promote additional private investment (like employers providing child care to employees).

### *Support for the Early Childhood Workforce*

While only a few states utilize tax credits for the early childhood workforce, such tax credits act as an income supplement by offsetting the low wage that many early childhood professionals make. In Montana, the average hourly wage is only $11.19. To be the most effective and accessible, it is recommended that early childhood workforce tax credits be large enough to boost income by a significant amount and should be fully refundable to ensure that the child care workforce can take full advantage of these wage supplements. Tying the credit to achievements such as early childhood credentials earned or higher education achieved, provides and incentive to strengthen core competencies that promote high-quality child care. With a refundable tax credit, low-wage individuals will also still be able to utilize the credit.

### *Encouraging Employer-Sponsored Child Care*

As mentioned earlier in this brief, Montana previously had a tax credit for employers who funded or provided child care, but it was eliminated by the state legislature in 2021. As showcased in the state examples, there are various levels at which to fund these kinds of tax credits. However, to effect change in the early childhood system, tax credits for businesses must be well-known, offer an adequate impact on tax liability, and assist employers with making up the significant costs to provide child care to employers. Across states that offer employer-sponsored child care tax credits, most are non-refundable. Thus, qualifying businesses that use the credit can only apply remaining credits to later tax years. The challenge in this regard is if a business has no tax liability, they have fewer reasons and resources to invest in child care or provide a critical service to their employees. A review could be undertaken to determine whether or not the credit was designed in a robust enough manner to prompt utilization and what level of incentive would most help engage businesses in supporting employee access to child care.

### *Linking Credits to Quality*

Assuming the state of Montana pursued various tax credits as a pathway to investing in child care, increasing access to quality child care will remain essential. A specific suggestion is to tie tax credits to quality ratings. As quality increases, so does the amount of the credit. This could apply to various types of credits, including for the workforce or employer-sponsored child care. For example, Montana policymakers could require businesses receiving incentives for on-site child care to participate in the STARS to Quality rating system and provide additional incentives for higher ratings. Although not discussed in this brief, credits for parents and families can also be based on quality.

## GENERAL POLICY PROPOSALS

Experts in the early childhood care and education system offer an assortment of recommendations for funding incentives to grow and strengthen child care access and quality.

- Funding strategies should address facilities, operations, and workforce issues in a coordinated manner, rather than treating them as distinct issues.
- Funding should be linked to quality.
    - On a related note, efforts across the state and federal governments to reduce administrative burdens, complexity, and rule conflicts could also be helpful to engage more employers in being part of our community child care solution.
- States may benefit from a mapping and gap analysis exercise, designed to identify all existing funding sources (including federal business and personal tax incentives), policy positions, regulatory or administrative barriers, and related items that would impact an employer's ability to sustain on-site or contracted child care support for employees.
- State governments can do more to coordinate and consolidate funding strategies to support child care providers and employers seeking to provide on-site child care or contract within the community to support employee child care needs. In both cases, owners are focused on running their businesses; navigating a complex web of federal and state funding tools can be a heavy burden. If a state created a portal or a toolkit that provides clear, concise information on financing tools and incentives, businesses may be more likely to pursue options to better support the child care needs of employees.
    - Statewide coordination efforts could also include a standing advisory committee of business owners, early care and education providers, and workforce leaders (including career and technical education, and community colleges).

# REFERENCES


Administration for Children & Families (2021). Early Childhood Finance Toolkit. Washington DC: SRI International.
https://childcareta.acf.hhs.gov/sites/default/files/public/pdgb5_financetoolkit_acc.pdf

Bipartisan Policy Center (2021). What is the Employer-Provided Child Care Credit (45F)?
https://bipartisanpolicy.org/blog/what-is-the-employer-provided-child-care-credit-45f/

Center for American Progress (2019). Early Learning in the United States.
https://www.americanprogress.org/article/early-learning-united-states-2019/

Committee for Economic Development. State Tax Credits for Child care.
https://www.ced.org/child-care-state-tax-credits

Government Accountability Office (2022). Employer Provided Child Care Credit: Estimated Claims and Factors Limiting Wider Use. Washington DC: US Government Printing Office.
https://www.gao.gov/assets/gao-22-105264.pdf

National Academies of Sciences, Engineering, and Medicine National Academies of Sciences, Engineering, and Medicine (2018). Transforming the Financing of Early Care and Education. Washington, DC: The National Academies Press. https://doi.org/10.17226/24984

New York State Senate (2021). Section 44, Employer-Provided Child Care Credit.
https://www.nysenate.gov/legislation/laws/TAX/44

North Carolina Early Childhood Foundation (2016). State Innovation Initiatives: Tax Credits.
https://earlysuccess.org/content/uploads/2020/03/State-Tax-Credit-Examples-NC-Early-Childhood-Foundation-Summary.pdf

United States Internal Revenue Service (2022). Publication 503 (2021), Child and Dependent Care Expenses. https://www.irs.gov/publications/p503