CHILD CARE CONTRIBUTION CREDIT

EVALUATION SUMMARY | SEPTEMBER 2021 | 2021-TE26

TAX TYPE	Income tax	REVENUE (TAX YEAR 2018)	$30.8 million
YEAR ENACTED	1998	NUMBER OF TAXPAYERS	18,200
REPEAL/EXPIRATION DATE	January 1, 2025		

KEY CONCLUSION: The credit provides a moderate incentive that appears to have encouraged private contributions to support child care in the state.

WHAT DOES THE TAX EXPENDITURE DO?

The Child Care Contribution Credit provides an income tax credit for taxpayers making monetary contributions to support child care, including, but not limited to, licensed child care facilities, unlicensed child care, organizations that provide educator training, referral services for child care, or financial support for parents to access child care. The credit is equivalent to 50 percent of the contribution amount, with a maximum credit of $100,000 per taxpayer, per tax year.

WHAT IS THE PURPOSE OF THE TAX EXPENDITURE?

Statute and the enacting legislation do not state the credit's purpose; therefore, we could not definitively determine the General Assembly's original intent. Based on our review of legislative history and the current operation of the expenditure, our evaluation considered a potential purpose: to incentivize taxpayers to contribute financial support to child care.

WHAT POLICY CONSIDERATIONS DID THE EVALUATION IDENTIFY?

The General Assembly may want to consider:

- Establishing a statutory purpose and performance measures for the credit.
- Clarifying eligible organizations that can receive contributions that qualify for the credit.

CHILD CARE CONTRIBUTION CREDIT

EVALUATION RESULTS

WHAT IS THE TAX EXPENDITURE?

The Child Care Contribution Credit provides a tax credit for taxpayers who make a monetary contribution "to promote child care in the state" [Section 39-22-121(1.5), C.R.S.]. Contributions must be given without an exchange for services (i.e., tuition or fee payments to a facility are not eligible.) Additionally, taxpayers cannot claim the credit for contributions to a child care facility if the taxpayer or a relative of theirs has a financial interest in the facility [Section 39-22-121(3), C.R.S.]. Under statute [Section 39-22-121(2), C.R.S.], eligible contributions include monetary contributions for:

- The establishment or operation of a child care facility.
- The establishment of a grant or loan program for parent(s) requiring financial assistance for child care.
- Training of child care providers.
- The establishment of an information dissemination program to provide information and referral services to assist parent(s) in obtaining child care.

Section 39-22-121(1.7), C.R.S., defines child care as "care provided to a child twelve years of age or younger." Eligible child care facilities include both nonprofit and for-profit organizations, and any licensed child care facility, including, but not limited to, child care centers, child placement agencies, foster care homes, homeless youth shelters, or residential child care facilities. In addition to licensed child care facilities, statute allows for contributions to child care centers that are not required to have a license, such as family child care homes that serve four or fewer children, or child care centers that are being built, as well as contributions to child care supportive programs, such as referral organizations or organizations that provide grants to child care facilities [Section 39-22-121(2) and (6.5), C.R.S.]. To manage the eligibility of contributions to organizations that are not required to have a license, the Department of Revenue (Department) regulations require any unlicensed child care program or service provider, including grant or loan programs and information dissemination and referral services, to register with the Department [1 CCR 201-2 Rule 39-22-121(6)]. Organizations must complete the Unlicensed Child Care Organization Registration Application (Form DR 1318) and the Department assesses whether the organization *supports child care* and qualifies for the exemption. The Department publishes a list of approved organizations that are not required to have a license on its website.

Taxpayers can claim the credit in an amount equal to 50 percent of the value of their contribution, up to a maximum of $100,000 each tax year. If the amount of the credit exceeds the taxpayer's income tax liability in any one year, they cannot claim a refund for the excess amount, but they can carry the unused amount forward for up to 5 years. Taxpayers claim the credit by submitting the Child Care Contribution Tax Credit Certification (Form DR 1317), which is completed by the organization that they contributed to, with their Colorado income tax return where they also report the credit amount claimed.

The Child Care Contribution Credit was originally established in 1990 through Senate Bill 90-161 and was initially limited to economically distressed areas of the state known as "enterprise zones." Specifically, Senate Bill 90-161 added contributions "to promote child care in enterprise zones… for the purpose of implementing the economic development plan for the enterprise zone" to the Enterprise Zone Contribution Credit, which provides tax credits for taxpayer contributions to approved projects that contribute to economic development and are located in enterprise zones. In 1998, the General Assembly passed Senate Bill 98-154, which established the Child Care Contribution Credit statewide and removed it from the requirements of the enterprise zone program. Since then, the credit has undergone several other substantial changes, including:

- House Bill 00-1351 revised the value of the credit for contributions made after January 1, 2000. The credit was increased from 25 percent of the contribution to 50 percent of the contribution. Additionally, beginning January 1, 2000, only monetary contributions were eligible for the credit and in-kind contributions (e.g., donations of stocks, equipment or other property) were no longer allowed.

- House Bill 04-1119 clarified that, for purposes of determining eligibility for the tax credit, 'contributions to child care' only include contributions to programs or services that serve children ages 0–12. The bill also included a provision to grandfather in organizations serving children ages 13–18 years old, if the organization was already approved and receiving contributions.

- House Bill 18-1004 extended the repeal date of the tax credit to 2025; currently taxpayers can receive a tax credit for any monetary contributions prior to January 1, 2025 and may carry unused credits forward through Tax Year 2029.

WHO ARE THE INTENDED BENEFICIARIES OF THE TAX EXPENDITURE?

Statute does not explicitly state the intended beneficiaries of the tax credit. However, based on its operation, we inferred that the intended beneficiaries are taxpayers contributing to qualified organizations and claiming the credit, as well as the qualified organizations that receive eligible contributions. According to an analysis of both Department of Revenue and Department of Human Services data conducted by the Colorado Children's Campaign, in 2017, there were approximately 6,000 child care centers, programs, or child care support organizations in the state that were eligible to receive these contributions.

Additionally, because the organizations that receive these contributions provide child care or provide financial support or referral services for parents, we inferred that the indirect beneficiaries include children who receive care supported by the contributions and parents who are able to access child care for their dependents.

Research from the Colorado Health Institute, on behalf of the Department of Human Services Office of Early Childhood, showed that in 2019, the demand for child care for children under age 5 in Colorado was about 34 percent higher than the supply of licensed child care or preschool programs. The research also found this gap reduces the ability of families to seek out employment, which disproportionately affects low-income, minority, and rural families. The supply gap exists because it is difficult for child care organizations to operate at the cost that parents are able to pay for child care. For example, according to research from the Committee for Economic Development, in 2017, the cost of child care in Colorado was about 14.4 to 21.6 percent of median household income. In 2018, infant care ranged from $10,500–$15,000 a year, while care for a 4-year-old child was only slightly less, at about $10,000–$12,100. While these costs make up a significant portion of many families' earnings, child care centers report that providing quality child care actually costs their facilities upwards of $15,000 per child, per year, and that higher quality rated centers with smaller class sizes must subsidize a significant portion of their expenses with sources other than parent tuition. Furthermore, according to stakeholders, the COVID-19 pandemic and resulting economic downturn, closures of child care centers, and increases in staff turnover has decreased the number of child care providers available in the state since 2020.

WHAT IS THE PURPOSE OF THE TAX EXPENDITURE?

Statute and the enacting legislation for the Child Care Contribution Credit do not state its purpose; therefore, we could not definitively determine the General Assembly's original intent. However, based on the credit's operation, legislative audio from 1998 and 2018, and interviews with stakeholders, we considered a potential purpose: to incentivize taxpayers to contribute financial support to child care organizations and services in the state. Specifically, during committee testimony for Senate Bill 98-154, one of the bill sponsors indicated that their intent was to expand financial support for all child care centers, not just those in enterprise zones, due to child care shortages across the state. During committee testimony for House Bill 18-1004, which extended contributions eligible for the credit through 2024, bill sponsors and stakeholders also cited the importance of providing financial support to child care centers to ensure that providers could cover their operating costs and, in turn, provide affordable and quality child care to children and their parents.

IS THE TAX EXPENDITURE MEETING ITS PURPOSE AND WHAT PERFORMANCE MEASURES WERE USED TO MAKE THIS DETERMINATION?

We determined that the Child Care Contribution Credit is likely meeting the potential purpose we considered for purposes of conducting this evaluation. Specifically, we found that the credit provides a moderate incentive for taxpayers to contribute to child care organizations and services supporting child care.

PERFORMANCE MEASURE #1: *To what extent has the tax credit incentivized taxpayers to contribute to child care organizations and services supporting child care?*

RESULT: Overall, we found that the Child Care Contribution Credit may encourage some taxpayers to contribute to child care organizations, as opposed to contributing to other types of charitable organizations. However, the credit appears to offer a stronger incentive for taxpayers to increase their contribution amount to child care organizations that they had already decided to contribute to.

Based on Department data on the total amount of credits claimed in Tax Years 2015 through 2018, we estimate that taxpayers who claimed the credit in those years made, on average, about $56 million in annual contributions to support child care in the state. Though we lacked data on the amount of contributions, we based our estimate on Department data showing an average of $28 million in annual credits claimed by taxpayers during those years, which should be at least half of the amount those taxpayers contributed based on the credit being 50 percent of the contribution amount. However, the annual amount contributed may be more than $56 million because the credit is capped at $100,000 and is not refundable and some taxpayers may not have had sufficient tax liability to claim the full value of the credit within the 5-year carry forward period or some taxpayers may have contributed, but not claimed the credit.

Despite a significant amount of contributions associated with the credit, we found that some taxpayers would likely have made contributions regardless of the credit, meaning that its true impact is less than the total amount of contributions that qualified taxpayers for the credit. To assess the strength of the credit as an incentive for taxpayers to contribute to child care organizations, we reviewed economic research on tax incentives and charitable giving, and interviewed stakeholder organizations that receive contributions.

It appears that the credit likely encourages some donors to contribute to child care organizations. According to research from the Tax Policy Center, tax credits and deductions for charitable giving effectively incentivize taxpayers to donate because they reduce donors' net cost of a contribution (i.e., the total amount of donors' contributions, less the value of any tax benefits they receive). Because the credit is calculated as 50 percent of the contribution amount, it provides a substantial potential reduction in the net cost of contributions. Furthermore, the credit is larger than other tax expenditures available for charitable contributions, which could incentivize some taxpayers to contribute to child care organizations instead of other types of organizations. Stakeholder organizations we contacted said that the 50 percent credit helps make contributions to child care organizations more attractive to donors than contributions to other organizations that do not offer as large of a tax benefit, and the credit's reduction in the net cost of the contribution allows taxpayers to contribute to more organizations. Taxpayers can also claim the credit for contributions to for-profit child care organizations, which would not otherwise be eligible for any tax incentive. Moreover, in 2018, the Colorado Children's Campaign conducted a survey of organizations that receive eligible contributions. Respondents stated that their donors mention the tax credit when making contributions, and that word of mouth from the organization staff will often draw in contributions from the community.

However, research also shows that other factors, including the donors' age, proximity to the organization, and personal connection to an organization or interest in an organization's mission may be more important to donors than the net cost of the contribution in deciding to contribute to charitable organizations. Donors' motivations can also vary based on whether they are individuals donating in their personal capacity versus businesses. For example, a corporation has different motivations to reduce taxable income than an individual and is more likely to be motivated primarily by a tax incentive; however, less than 1 percent of taxpayers claiming the credit are corporations. Additionally, for our evaluation of the Enterprise Zone Contribution Credit, which also provides a credit to taxpayers making contributions, we surveyed taxpayers who contributed to enterprise zone projects about their motivations for charitable contributions in general. Respondents ranked the mission of the organization and contributing to local organizations in their community as the strongest factors for charitable contributions, followed by tax incentives such as credits and deductions. This is likely true for taxpayers making contributions to child care organizations as well, as several taxpayers that we surveyed for the Enterprise Zone Contribution Credit also contributed to child care organizations.

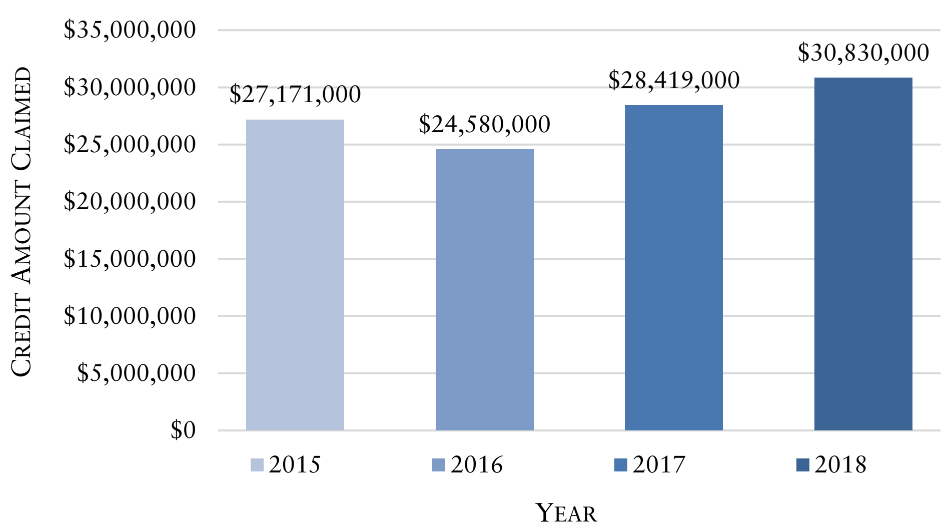
In general, according to the Tax Policy Center, the higher a taxpayer's disposable income, the less likely it is that the contribution cost influences the initial decision to make a contribution, but the more likely the taxpayer is to take advantage of credits or deductions, since individuals with higher incomes tend to have more tax liability to offset. This trend could impact the Child Care Contribution Credit because, as discussed below, we found that in Tax Year 2017, 85 percent of the total amount of credits claimed were claimed by taxpayers with an adjusted gross income of $200,000 or more. Additionally, in the case of the Child Care Contribution Credit, taxpayers who itemize their federal deductions and claim the federal charitable contribution deduction receive a reduced tax benefit from the credit. Specifically, federal regulations require these taxpayers to reduce their federal deduction by the amount of any state level credits they receive for the contribution. For taxpayers at the highest federal tax bracket, 37 percent, this requirement effectively reduces the overall tax benefit of the Child Care Contribution Credit from 50 percent to 31.5 percent of the amount contributed. For example, if a taxpayer makes a $100,000 contribution to a nonprofit child care center and receives a 50 percent tax credit, they could only claim a $50,000 deduction on their federal income taxes, and would now owe federal taxes on an additional $50,000 in income (the value of the state credit), which would result in $18,500 in additional federal income tax owed for an individual in the highest federal tax bracket. This reduces the $50,000 benefit (50 percent) down to $31,500 (31.5 percent). Higher income taxpayers who make large contributions are also more likely to benefit from itemizing their federal deductions, so this requirement likely reduces the incentive provided by the credit for a significant portion of the beneficiaries.

While the credit may play a moderate role in influencing taxpayers to contribute to child care organizations, there is evidence that the credit incentivizes taxpayers who have already decided to contribute to childcare organizations to increase the amount of their contribution. We interviewed four non-profit organizations that receive contributions under the credit and all of them mentioned that they market the tax credit as a way to increase the size of taxpayers' initial contributions. Stakeholders also reported that once their donors find out about the tax credit, they will often double their original contribution because they can give twice the amount of money for the same net cost. Similarly, when we surveyed taxpayers who claimed the Enterprise Zone Contribution Credit, the majority responded that the credit for enterprise zone contributions caused them to increase the amount of the contribution they had planned. Thus, the Child Care Contribution Credit likely has a similar impact on a taxpayer's decision to contribute.

WHAT ARE THE ECONOMIC COSTS AND BENEFITS OF THE TAX EXPENDITURE?

The Department reported that between Tax Years 2015 and 2018 the credit's state revenue impact was about $111 million, or an average of $28 million per year. In Tax Year 2018, the most recent year of tax data available, the credit had a revenue impact to the State of $30,830,000, an increase from the impact amount from the prior 3 years; however, we did not have the data to assess the reason for the increase. Exhibit 1 shows the revenue impact for Tax Years 2015 through 2018.

EXHIBIT 1. CHILD CARE CONTRIBUTION CREDIT
STATE REVENUE IMPACT
TAX YEARS 2015 THROUGH 2018

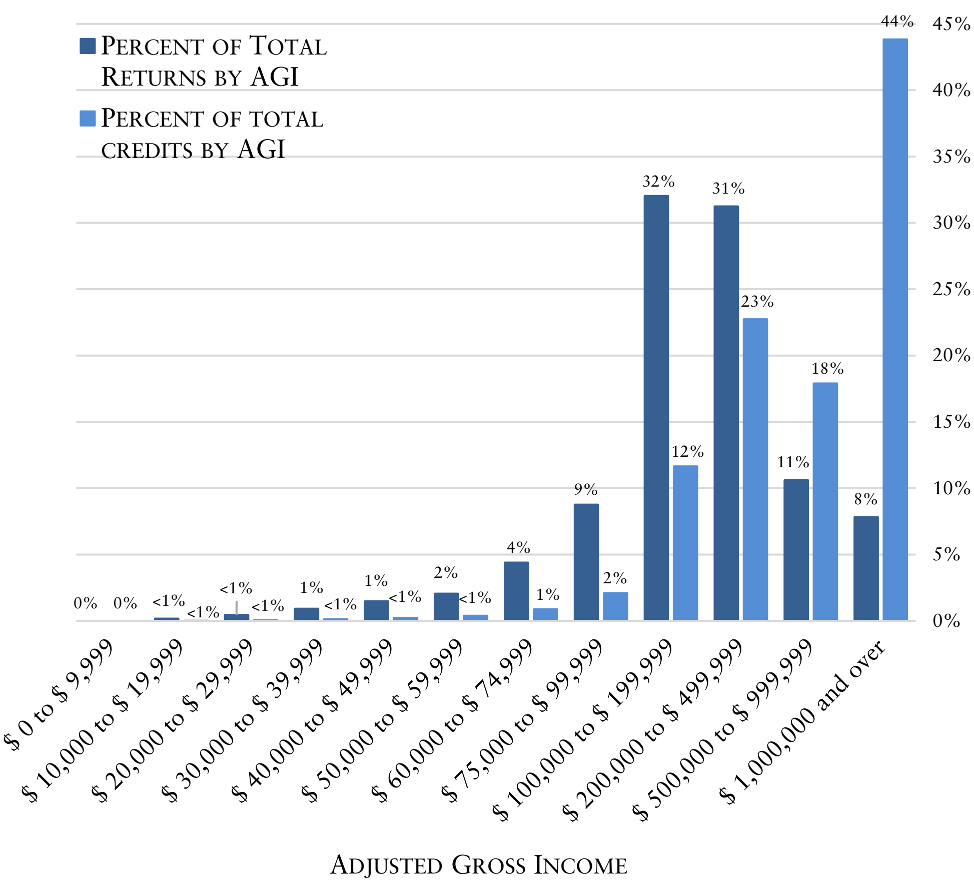


SOURCE: Office of the State Auditor analysis of Department of Revenue data for taxpayers claiming the contribution credit in Tax Years 2015, 2016, and 2018 and Department of Revenue 2020 Tax Profile and Expenditures Report for the 2017 Statistics of Income.

We found that taxpayers with higher incomes tend to make most of the eligible contributions and benefit most from the credit. Exhibit 2 shows the breakdown of the percent of full-year Colorado resident taxpayers, by adjusted gross income, who claimed the Child Care Contribution

Credit, and the percentage of the total credits claimed by each adjusted gross income level in Tax Year 2017, the most recent year data were available. As shown, taxpayers with an adjusted gross income of at least $100,000 claimed 96 percent of the total credit amount claimed and made up about 82 percent of the returns filed. On the highest end, taxpayers with adjusted gross incomes over $1 million claimed more than 40 percent of the credits, but made up only 8 percent of the returns filed.

EXHIBIT 2. PERCENT OF RETURNS[1] CLAIMING THE CHILD CARE CONTRIBUTION TAX CREDIT BY AGI, AND PERCENT OF THE CREDIT CLAIMED BY AGI, TAX YEAR 2017



SOURCE: Office of the State Auditor analysis of Department of Revenue 2020 Tax Profile and Expenditures Report for the 2017 Statistics of Income.
[1]Full year Colorado resident returns only.

Because we lacked data on the organizations that received contributions and how they spent the funds, we were unable to assess the impact of the contributions on staff wages, affordability of child care, child care facilities, or child care service quality. An impact study conducted by Development Research Partners in 2011 on the benefits of the Child Care Contribution Credit found that the majority of child care organization operating expenses are for salaries and benefits, and the remainder constitutes things like equipment, materials, utilities, transportation, and facility costs. Additionally, a 2018 survey conducted by the Colorado Children's Campaign reported that organizations that receive contributions under the credit spend the funds on staff training and improved salaries as well as covering operational expenses, and financial assistance to families.

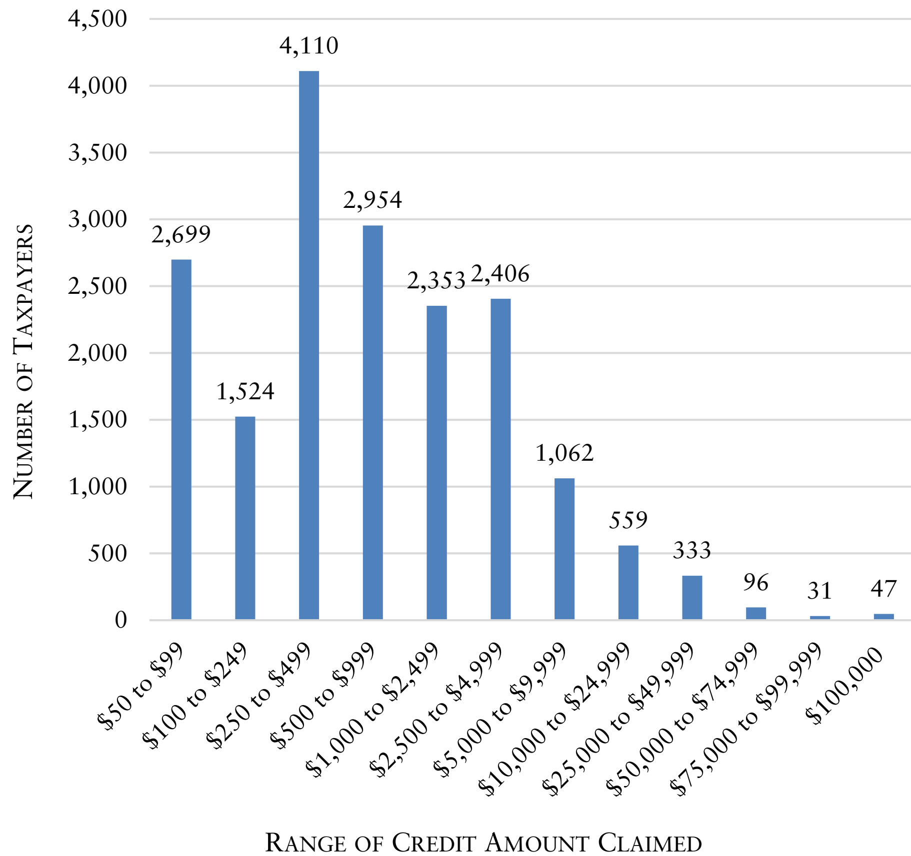
Additionally, the Child Care Contribution Credit impact study prepared by Development Research Partners in 2011 estimated that child care organizations spend about 90 percent of contributions within Colorado, having a secondary impact of recirculating contributions into the Colorado economy. Based on this estimate, of the approximately $61.6 million we estimate was contributed to child care organizations in Tax Year 2018, about $55.4 million (90 percent) was likely spent in Colorado for staff salaries and benefits, facility costs, materials, and equipment.

WHAT IMPACT WOULD ELIMINATING THE TAX EXPENDITURE HAVE ON BENEFICIARIES?

If the Child Care Contribution Credit was eliminated, taxpayers who currently claim the credit would see their tax liability increase to the extent that they continue to make contributions. Based on Department data, for Tax Years 2015, 2016, and 2018 there were approximately 36,000 unique taxpayers that claimed the credit and most only claimed the credit in one tax year. For the most recently available year, Tax Year 2018, about 18,200 taxpayers claimed the credit and approximately 99.6 percent were individuals and .04 percent were corporations. Exhibit 3 shows the distribution of credit amounts claimed in Tax Year

2018. Although a small percentage of taxpayers received credits of $10,000 or more (6 percent), about 8,300 taxpayers (46 percent) received less than $500 in credits, with a median amount claimed of $333, which would no longer be available if the credit was eliminated.

EXHIBIT 3. DISTRIBUTION OF CHILD CARE CONTRIBUTION CREDIT AMOUNTS CLAIMED
TAX YEAR 2018



SOURCE: Office of the State Auditor analysis of Department of Revenue data for taxpayers claiming the contribution credit in Tax Year 2018.

However, it is possible that if the Child Care Contribution Credit was not available, some of these taxpayers would continue to make contributions to non-profit organizations and still be able to claim other tax expenditures. For example, taxpayers could continue to claim the state-level Charitable Contribution Deduction, which is available to taxpayers who make contributions to charitable organizations and do not itemize their deductions at the federal level (meaning that they did not claim a deduction for their contribution on their federal tax return). Taxpayers that are contributing to for-profit child care facilities would not be able to claim another tax expenditure for the same contributions, but might shift their contributions to non-profit organizations that offer credits or deductions. Therefore, eliminating the credit could have the effect of shifting some of the current state revenue impact to a different tax expenditure.

In addition to the credit's impact on taxpayers, stakeholders reported that repealing the Child Care Contribution Credit may reduce the amount of contributions to child care organizations. In 2017, the Colorado Children's Campaign estimated that more than 6,000 organizations across the state were eligible to receive contributions; however due to data limitations, the exact number of organizations that received contributions is unknown. Further, information from a 2018 Colorado Children's Campaign survey of child care providers showed that contributions generally fund day-to-day operational expenses, the majority of which are for staffing. In general, stakeholders reported that if operations budgets decreased, organizations would need to either reduce staff or reduce wages, forgo facility improvements, reduce programming, or reduce or eliminate scholarship funding for child care.

Some organizations may be impacted more than others if the credit were eliminated; for example, two of the organizations that we interviewed that serve vulnerable children rely heavily on private contributions to provide no-, or low-cost infant and toddler care and after-school programs. Anecdotally, stakeholders had concerns that they would have to reduce staff that are highly trained for early childhood development or care for school-aged at-risk youth, impacting the quality of child care provided as well as employment in the child care industry. All stakeholders expressed concern for the social impacts that a reduction in their services could have, specifically, that it would create additional barriers for lower income and minority children to succeed in school and for low-income families to maintain employment. Further, because there would no longer be any tax incentives for contributions made to for-profit child care facilities, eliminating the credit could cause a greater reduction in contributions to these facilities. Based on Department of Human Services' data on licensed child care facilities, approximately 1,200 of the State's roughly 5,000 licensed facilities operate as for-profit child care facilities; data on the number of for-profit child care facilities that are not required to be licensed is not available.

Additionally, if the credit were repealed and contributions to child care organizations were reduced, in order to maintain or increase availability of child care, the State may need to address the gap with additional funding. According to 2016 federal data, in Colorado, state and federal funding for child care totaled about $190 million and represented about 25 percent of child care facility revenues.

ARE THERE SIMILAR TAX EXPENDITURES IN OTHER STATES?

In addition to Colorado, we identified four other states that offer tax expenditures that are similar to the Child Care Contribution Credit, although there is variation in how the tax expenditures operate. Exhibit 4 shows four other states that have similar tax credits to promote child care.

EXHIBIT 4. OTHER STATES' CONTRIBUTION TAX CREDITS

State	Summary
Louisiana	**School Readiness Tax Credits**—Package of tax credits that support child care in an effort to encourage child care facilities to participate in the Louisiana Department of Education's quality rating program. **Credit for Child Care Directors and Staff**—Refundable tax credit for child care staff who work at a licensed child care facility that participates in the state quality rating system. The credit is based on the education level that staff attained through the Louisiana Pathways Child Care Career Development System. **Tax Credit for Business Supported Child Care**—Refundable tax credit for businesses that support child care at facilities that participate in the state quality rating system. This includes facility construction or expansion or operations expenses, payments to facilities to support child care services for employees, or the purchase of child care slots for employees. The credit is limited to $50,000 per year and is based on the quality rating of the child care facility that the business contributes to.

	Tax Credit for Donations to Resource and Referral Agencies—Refundable tax credit for individuals or businesses that donate to child care resource and referral agencies. The credit is equal to the value of the donations, up to a maximum of $5,000 per year.
Mississippi	**Children's Promise Tax Credits—**Tax credits for businesses and individuals for contributions to charitable organizations that serve at-risk and vulnerable children. **Eligible Charitable Organization Tax Credit Program—**Business income tax credit for contributions to organizations that are licensed or under contract with the Department of Child Protection Services and provide services to children in foster care, for adoption of children, or support children remaining in family custody, or are an educational services organization for children with a chronic illness or disability or for children from low-income families. Tax credits for businesses are limited to no more than 50 percent of the businesses' total tax liability; total credits for contributions cannot exceed $5 million, or $1.25 million per charitable organization. **Qualifying Foster Care Charitable Organization Tax Credit—**Tax credit for individuals, up to $500 for individual taxpayers and $1,000 for joint filers, for contributions to qualifying foster care charitable organizations. The credit may be carried forward for up to 5-years. Statewide cap of $1 million per year.
Oregon	**Contribution to the Office of Child Care—**Tax credits for businesses and individuals for contributions to the state's Office of Child Care to encourage taxpayers to provide financial support to achieve goals for targeted communities and populations, strengthen and improve professional development of child care providers, and encourage providers to increase the quality of care. The tax credit is equal to 50 percent of the value of the contribution (including stocks), and may be carried forward for up to 5 years. Statewide cap of $500,000 per year.
Pennsylvania	**Educational Improvement Tax Credit—**Tax credit for corporations that contribute to pre-kindergarten scholarship programs, as well as other education programs for school-aged children to assist families with tuition costs. The tax credit is equal to 75 percent of the value of the contribution (or 90 percent if the corporation commits to at least two consecutive annual contributions), capped at $750,000. Statewide cap of $12.5 million in credits for contributions to pre-kindergarten scholarships.

SOURCE: Office of the State Auditor analysis of Bloomberg Bureau of National Affairs (BNA) information on tax provisions, state statutes, and state Department of Revenue and Department of Education information.

ARE THERE OTHER TAX EXPENDITURES OR PROGRAMS WITH A SIMILAR PURPOSE AVAILABLE IN THE STATE?

Statute provides the following tax expenditures, which are similar to the Child Care Contribution Credit:

CHILD CARE FACILITY INVESTMENT TAX CREDIT AND EMPLOYER CHILD CARE FACILITY INVESTMENT TAX CREDIT [SECTION 39-22-517, C.R.S.].— Allows any person operating a child care center, family child care home, or foster care home a tax credit of 20 percent of their annual investment in property that is used for the operation of the child care facility. Child care facilities can receive contributions to invest in property for the child care facility, making the donors eligible for the Child Care Contribution Credit and then the facility can claim a Child Care Facility Investment Tax Credit. In addition, any corporation that provides child care facilities that are incidental to their business and are used by its employees may claim a credit of 10 percent of the investment in property that is used for the operation of the child care facility. Both of these credits may be carried forward for up to 3 years.

CHILD CARE EXPENSE CREDIT AND LOW-INCOME CHILD CARE EXPENSE CREDIT [SECTION 39-22-119 AND 119.5, C.R.S.]—Statute states that the purpose of these credits is to "make child care more affordable for working families." The Child Care Expense Credit allows taxpayers with an adjusted gross income of $60,000 or less and who are claiming the federal Child and Dependent Care Tax Credit to claim up to 50 percent of their federal credit amount on their state income tax return, up to $525 for a single child or $1,050 for two or more children. The Low-Income Child Care Expense Credit allows taxpayers that have an adjusted gross income of $25,000 or less, but do not have a sufficient tax liability to claim the federal Child and Dependent Care Tax Credit, to claim up to 25 percent of their annual child care expenses, up to $500 for a single child or $1,000 for two or more children. For both credits, taxpayers may receive the amount of the credit as a refund if it exceeds their state income tax liability.

ENTERPRISE ZONE CONTRIBUTION CREDIT [SECTION 39-30-103.5, C.R.S.]—Allows taxpayers a credit for 25 percent of the value of their contribution to an approved enterprise zone project, up to $100,000. In-kind contributions are allowed, but are limited to 50 percent of the value of the credit. Approved enterprise zone projects must contribute to the enterprise zones' economic development goals. As discussed, the Child Care Contribution Credit was originally enacted in 1990 as part of the Enterprise Zone Contribution Credit, and was then split off into a separate statewide tax credit in 1998. A small number of enterprise zone contribution projects serve children, such as capital projects for community facilities, however the main purpose of these projects is not to provide care for children ages 0-12. Additionally, some larger nonprofit organizations act as pass through entities for both credits, collecting funds and processing credit certifications for smaller donor choice entities.

CHILD TAX CREDIT [SECTION 39-22-129, C.R.S.]—Allows for a refundable state tax credit for taxpayers with children under 6 years of age. The state credit is calculated from the amount of the federal credit, and ranges from 5 to 30 percent of the federal credit amount, based on the taxpayer's adjusted gross income. In 2021, the General Assembly passed House Bill 21-1311, which beginning January 1, 2022, will allow taxpayers who have an eligible child, but that do not meet the IRS eligible child criteria and cannot claim the federal credit to still claim the state credit.

STATE AND FEDERAL CHARITABLE CONTRIBUTION DEDUCTIONS [SECTION 39-22-104(4)(m), C.R.S. AND 26 CFR 1.170A-1]—State statute—allows an individual to deduct the amount of any charitable contributions totaling at least $500 from their state income tax, if the individual claimed the standard federal deduction. Taxpayers can still claim both the Child Care Contribution Credit as well as the state Charitable Contribution Deduction if they claimed the standard federal deduction. Additionally, for federal taxable income, taxpayers who itemize their deductions can claim an income tax deduction for the value of their charitable contribution, up to a certain percentage of their adjusted gross income. However, as of 2019, the IRS-issued regulations [26 CFR 1.170A-1(h)(3)] require taxpayers taking the itemized deduction and the federal charitable contribution deduction to reduce that deduction by the amount of any state tax credits they expect to receive that are over 15 percent of the value of the deduction. Therefore, if a taxpayer claims the Child Care Contribution Credit for a contribution to a charitable organization, as well as the federal charitable contribution deduction, they will need to adjust their federal charitable contribution deduction amounts.

In addition to tax expenditures, the state provides other financial assistance programs for child care and early childhood education:

COLORADO CHILD CARE ASSISTANCE PROGRAM (CCCAP)—- The Department of Human Services administers the CCCAP program, which provides child care assistance to families with incomes of up to 185 percent of the federal poverty level and are employed, looking for work, or enrolled in an education program. Under CCCAP, counties receive an allocation of state funding and are responsible for establishing eligibility standards based on state guidelines and prioritizing which families receive financial assistance. In Fiscal Year 2020, CCCAP spent about $116.5 million to provide financial assistance to families to reduce the cost of child care for about 26,500 children. According to the 2019 Colorado Shines Brighter report—a birth-through-age-5 needs assessment from the Colorado Health Institute and the Office of Early Childhood—about 40 percent of licensed child care facilities accept CCCAP, and about 8 percent of the income-eligible population is enrolled. CCCAP recipients are also eligible for the Child Care Credit and Low-Income Credit; however, CCCAP recipients can only claim credits based on their out-of-pocket child care expenses not covered by CCCAP.

COLORADO PRESCHOOL PROGRAM (CPP)—The CPP is administered by the Department of Education and provides funding for eligible children to attend half or full-day preschool or full-day kindergarten located in public schools, child care centers, community preschools, or Head Start programs. In Fiscal Year 2019 the Department of Education was appropriated about $122.5 million to serve 29,360 children, which it estimated served approximately 38 percent of eligible children for the 2019-2020 school year. Families who receive assistance through the program remain eligible to claim the Child Care Credit and Low-Income Credit, though their credits are calculated based only on their out-of-pocket child care costs.

GRANTS FOR CHILD CARE SECTOR—During the 2020 and 2021 Legislative Sessions, the General Assembly passed multiple bills to support the child care sector and to help it recover from the impacts of the COVID-19 pandemic. During the 2020 Special Legislative Session, the General Assembly passed House Bill 20B-1002, Emergency Relief Programs for Child Care Sector. This bill created two emergency relief grant programs to provide financial support to licensed providers in order to maintain operations and capacity, or to open new facilities or expand existing capacity. During the 2021 Legislative Session, the General Assembly passed Senate Bill 21-236 to increase the capacity of quality early childhood education facilities. This bill created four additional grant programs, using state and federal funds, for:

- The construction, renovation, or remodeling of employer-based child care facilities.
- Child care centers to cover tuition, fees, materials, credentialing, licensing, and wage increases for early childhood staff for recruitment and retention.
- Wage increases for early childhood educators working at centers that serve families that are subsidized with CCCAP.
- Community-based programs that cover tuition subsidies or scholarships, employer-based cost sharing, ensure equitable access for all children, and strengthen child care business practices that improve early childhood outcomes.

State expenditures for these grant programs are expected to be $379.2 million in Fiscal Year 2022 and $65.7 million in Fiscal Year 2023.

WHAT DATA CONSTRAINTS IMPACTED OUR ABILITY TO EVALUATE THE TAX EXPENDITURE?

The Department could not provide data on the number, location, and types of organizations that received contributions. As discussed, taxpayers must submit a Child Care Contribution Tax Credit Certification (Form DR 1317), which is completed by the organization that the taxpayer contributed to, and lists the amount of the contribution and the organization's name, location, and license number, if applicable. However, the Department's tax processing and information system, GenTax, does not capture the information on the form in a format that would allow it to be systematically extracted. Instead, each form must be reviewed manually. Therefore, if the General Assembly determined that this information is necessary, it could direct the Department to begin capturing this information in GenTax in an extractable format. According to the Department, making this type of change would require resources to develop the ability to store the organizations' information in a database format, rather than a scanned image file, and to develop the query to pull this information from GenTax (see the Tax Expenditures Overview section of the Office of the State Auditor's *Tax Expenditures Compilation Report* for additional details on the limitations of Department data and the potential cost of addressing these limitations).

WHAT POLICY CONSIDERATIONS DID THE EVALUATION IDENTIFY?

THE GENERAL ASSEMBLY MAY WANT TO CONSIDER AMENDING STATUTE TO ESTABLISH A STATUTORY PURPOSE AND PERFORMANCE MEASURES FOR THE CHILD CARE CONTRIBUTION CREDIT. As discussed, statute and the enacting legislation for the credit do not state the credit's purpose or provide performance measures for evaluating its effectiveness. Therefore, in order to conduct our evaluation, we considered a potential purpose for the exemption: to incentivize taxpayers to contribute financial support to organizations that promote child care in the state. We identified this purpose based on the statutory language about the credit and how the credit operates, as well as from legislative testimony and feedback from stakeholders. We also developed performance measures to assess the extent to which the exemption is meeting this potential purpose. However, the General Assembly may want to clarify its intent for the exemption by providing a purpose statement and corresponding performance measure(s) in statute. This would eliminate potential uncertainty regarding the credit's purpose and allow our office to more definitively assess the extent to which the credit is accomplishing its intended goal(s).

THE GENERAL ASSEMBLY MAY WANT TO CONSIDER CLARIFYING WHICH TYPES OF ORGANIZATIONS ARE ELIGIBLE TO RECEIVE CONTRIBUTIONS THAT QUALIFY FOR THE CREDIT. Statute [Section 39-22-121, C.R.S.] allows for taxpayers to claim the credit for a range of contributions that "promote child care in the state." Statute further specifies that eligible contributions include those made to a "child care facility," which is a facility licensed by the Department of Human Services, and includes, but is not limited to, "day care centers, school-age child care centers, before and after school programs, nursery schools…preschools, day camps, summer camps,"[Section 26-2-102(5), C.R.S.] as well as child placement agencies, family child care homes, homeless youth shelters, residential child care facilities, and secure residential treatment centers [Section 39-22-121(6.5)(a), C.R.S.]. Statute also states that "a child care program that is not a child care facility [i.e., licensed by the Department of Human Services] but provides child care services similar to those provided by a child care center" is also eligible [Section 39-22-121(2)(a), C.R.S.]. Furthermore, contributions to both for-profit and nonprofit child care centers are eligible. The Department of Revenue allows contributions to any licensed facility, as well as unlicensed organizations, as long as unlicensed organizations meet the criteria in statute of providing "services similar to those provided by a [licensed] child care center" [Section 39-22-121(2)(a), C.R.S.], and register with the Department of Revenue.

Therefore, while it appears that the General Assembly intended for contributions to a broad range of organizations to qualify and stakeholders reported that this is beneficial because it allows taxpayers to support a wide variety of child care organizations, statute does not establish clear limits on the types of activities and organizations that provide child care for the purposes of the credit. Specifically, Department of Revenue staff stated that, in some instances, it is clear that an organization offers care "similar to a child care facility," for example, after-school programs licensed by the Department of Education, in-home family care that serves four or fewer children, or child care facilities that are raising funding to begin operations. However, other organizations are not as clear, such as centers for religious instruction (e.g., confirmation, bar mitzvah, or bat mitzvah instruction), centers where children are working on single skill building (e.g., sports camps or ski and snowboard school), or recreation center child care. As an example, the Department of Revenue has approved day camps and child care at recreational centers, but denied the application of a ski school for children on the basis that the essential purpose of the center was not for the "comprehensive care of children when the parents or guardians are employed or otherwise unavailable." While the Department's interpretation of statute appears reasonable, it is not clear that this interpretation aligns with the General Assembly's intent for the credit as statute does not clearly state this intent. Department staff have stated that further specificity and clarity on the General Assembly's intent or definition of child care that should qualify would be beneficial to ensure it approves contributions to organizations that the General Assembly intended to benefit from the credit.

Although changes to the eligibility requirements could have an impact on the amount of eligible contributions child care organizations receive and could change the credits' revenue impact to the state, as previously discussed, we lacked data necessary to quantify the amount of contributions that were received by each type of organization and the associated revenue impact.