# CHILD CARE FACILITY INVESTMENT CREDITS

EVALUATION SUMMARY | JANUARY 2022 | 2022-TE8

| Expenditures | Facility Owner Investment Credit | Employer Facility Investment Credit |
| --- | --- | --- |
| Tax Type | Income tax | |
| Year enacted | 1992 | |
| Repeal/Expiration date | None | |
| Revenue impact (Tax Year 2018) | $114,458 - $267,164 | $0 |
| Number of Taxpayers (Tax Year 2018) | Could not determine | None |

**KEY CONCLUSION:** The Facility Owner Investment Credit provides a relatively small amount of support to some for-profit child care facilities in the state, though many eligible facilities do not claim it. Additionally, the Employer Facility Investment Credit has been rarely used in recent years and does not appear to provide an effective incentive to encourage employers to provide child care facilities for their employees.

## WHAT DO THESE TAX EXPENDITURES DO?

Facility Owner Investment Credit [Section 39-22-517(1), C.R.S.]—Allows the owners of licensed child care facilities, family care homes, and foster care homes a tax credit for 20 percent of their investment in qualified property and equipment.

Employer Facility Investment Credit [Section 39-22-517(2), C.R.S.]—Allows employers that operate a licensed child care facility for their employees a tax credit for 10 percent of the employer's investment in qualified property and equipment for the facility. The child care facility must be 'incidental' to the business, meaning that it cannot be a major part of the employer's business activities.

## WHAT IS THE PURPOSE OF THESE TAX EXPENDITURES?

Statute and the enacting legislation for the Child Care Facility Investment Credits do not state the purpose of the credits; therefore, we could not definitively determine the General Assembly's original intent. However, based on the legislative testimony recordings from the enacting bill (House Bill 92-1191), the General Assembly's ongoing legislative efforts to address the availability of child care, and the credits' operation, we inferred a potential purpose for each credit:

Facility Owner Investment Credit—To provide financial assistance to for-profit child care facilities by making property and equipment more affordable in order to help facilities stay open.

Employer Facility Investment Credit—To incentivize employers to provide child care facilities for their employees by making property and equipment for the facility operations more affordable.

## WHAT POLICY CONSIDERATIONS DID THE EVALUATION IDENTIFY?

The General Assembly may want to consider:

- Establishing a statutory purpose and performance measures for the credits.
- Reviewing the effectiveness of the credits and either repealing them or making changes to increase their impact.

# CHILD CARE FACILITY INVESTMENT CREDITS

## EVALUATION RESULTS

### WHAT ARE THE TAX EXPENDITURES?

The Child Care Facility Investment Tax Credits provide taxpayers with income tax credits for investments in tangible personal property and equipment for the operation of a child care center [Section 39-22-517, C.R.S.]. There are two credits available:

FACILITY OWNER INVESTMENT CREDIT [SECTION 39-22-517(1), C.R.S.]—Allows the owners of licensed child care facilities, family care homes, and foster care homes a tax credit for 20 percent of their investment in qualified property and equipment.

EMPLOYER FACILITY INVESTMENT CREDIT [SECTION 39-22-517(2), C.R.S.]—Allows employers that operate a licensed child care facility for their employees a tax credit for 10 percent of the employer's investment in qualified property and equipment for the child care facility. The child care facility must be 'incidental' to the business, meaning that it cannot be a major part of the employer's business activities.

Qualified investments for both credits include purchases of items that are depreciable and have a useful life of more than 1 year (e.g., crib mattresses, stoves, vehicles, and playground equipment). Operating expenses (e.g., rent, utilities, and property taxes), purchases of real estate, and single use products (e.g., paper products, diapers, food, and office supplies) are not eligible.

If the amount of either credit exceeds the taxpayer's income tax liability in any year, the taxpayer cannot claim a refund for the excess amount, but they can carry the unused amount forward for up to 3 years [Section 39-22-517(3), C.R.S.]. Individual taxpayers claim the credits on the 2020 Individual Credit Schedule (Form DR 0104CR), lines 21 and 22, and corporations claim the credits on the 2020 Credit Schedule for Corporations (Form DR 0112CR), lines 11 and 12. As part of the claim, taxpayers are required to submit their facility license number and a list of the qualified property and equipment they bought.

Both of the Child Care Facility Investment Credits were originally established in 1992 through House Bill 92-1191 and have not been modified substantially since.

## WHO ARE THE INTENDED BENEFICIARIES OF THE TAX EXPENDITURES?

Statute does not state the intended beneficiaries of the credits. Based on our review of legislative testimony recordings from the credits' enacting legislation (House Bill 92-1191), the credits' operation, as well as a review of research on the child care industry in Colorado (e.g., typical expenses, profit margins, types of operators, etc.), we inferred that each credit has its own intended direct beneficiaries, but that the two credits have similar indirect beneficiaries.

The Facility Owner Investment Credit directly benefits for-profit child care facilities that buy qualified equipment and property. Department of Human Services (Human Services) data indicate that about 1,200 of the State's 5,000 licensed facilities (about 24 percent) reported operating on a for-profit basis and would be able to claim the income tax credit. Nonprofit entities are not eligible to claim the credit since they do not pay income taxes to the State.

The Employer Facility Investment Credit directly benefits employers that provide child care for their employees and that buy qualified equipment and property for the child care facility. While the exact number is unknown, stakeholders reported that there are very few employers in Colorado that operate a child care facility for their employees.

Additionally, because child care facilities and employers that claim the credit are investing in equipment and property used to care for children in the facilities, we inferred that the indirect beneficiaries of both credits include those children and their parents.

Accessibility of quality, affordable child care has been an ongoing national issue. In Colorado specifically, research from the Colorado Health Institute, on behalf of Human Services' Office of Early Childhood, showed that in 2019, the demand for child care for children under age 5 was about 34 percent higher than the supply of licensed child care or preschool programs. This gap reduces the ability of families to seek out employment, which disproportionately affects low-income, minority, and rural families as well as women. 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, Colorado families paid about $10,500-$15,000 a year for infant care and $10,000-$12,100 for care for a 4-year old child. While these costs make up a significant portion of many families' earnings, child care centers nationally report that the average cost to provide center based infant care is about $14,800 and $9,100 for care for preschoolers, per year, per child. Further, according to stakeholders, the COVID-19 pandemic and resulting economic downturn has led to increases in staff turnover and operating costs, as well as reductions in capacity and revenue, thereby reducing the number of child care providers available in the state since early 2020.

## WHAT IS THE PURPOSE OF THE TAX EXPENDITURES?

Statute and the enacting legislation for the Child Care Facility Investment Credits do not state the purpose of the credits; therefore, we could not definitively determine the General Assembly's original intent. However, based on the legislative testimony recordings from the enacting bill (House Bill 92-1191), the General Assembly's ongoing legislative efforts to address the availability of child care, and the credits' operation, we inferred a potential purpose for each credit:

FACILITY OWNER INVESTMENT CREDIT—To provide financial assistance to for-profit child care facilities by making property and equipment more affordable in order to help facilities stay open.

EMPLOYER FACILITY INVESTMENT CREDIT—To incentivize employers to provide child care facilities for their employees by making property and equipment for the facility operations more affordable.

## ARE THE TAX EXPENDITURES MEETING THEIR PURPOSES AND WHAT PERFORMANCE MEASURES WERE USED TO MAKE THIS DETERMINATION?

We could not definitively determine if the Child Care Facility Investment Credits are meeting their purposes because statute and the enacting legislation do not provide purposes for the credits. However, we found that the Facility Owner Investment Credit is likely only meeting the purpose we considered for this evaluation to a limited extent because it is rarely used. Additionally, we found that the Employer Facility Investment Credit is not meeting the purpose we considered because employers are not using the credit.

Due to taxpayer reporting errors, discussed in detail below, we could not determine the exact number of child care facilities or employers that claimed the Child Care Facility Investment Credits for Tax Years 2015 through 2018.

PERFORMANCE MEASURE #1: *To what extent has the Facility Owner Investment Credit provided financial assistance to child care facilities by making certain property and equipment more affordable in order to help facilities stay open?*

RESULT: Overall, we found that the credit is used by a small proportion of eligible child care facilities and provides a relatively small amount of financial assistance to facilities.

First, data indicate that fewer than half of the State's 1,200 for-profit child care facilities claimed the credit for Tax Year 2018, the most recent year of available data. Although the Department of Revenue (Revenue) reported that 538 taxpayers claimed the credit in Tax Year 2018, upon reviewing documentation of income tax filings in GenTax, we found that many of the taxpayers made filing errors by filing forms for the Child Care Contribution Credit or Enterprise Zone Contribution Credit, but listing the credit on their tax returns as the Facility Owner Investment Credit. These filing errors did not affect actual revenue to the State or the taxpayers' final tax liability, but they did affect the accuracy of the Department's data on the use of the Facility Owner Investment Credit. For example, we found that in a sample of 29 taxpayers, 17 taxpayers (59 percent) who claimed the credit appear to have intended to claim other credits and may not have been eligible for the Facility Owner Investment Credit. Though we cannot project this error rate to the entire population, our review indicates that many potentially eligible child care facilities are not using the Facility Owner Investment Credit.

Second, we determined that the credit provides a relatively small monetary benefit to facilities that claim it. Due to taxpayer misreporting, we could not estimate the average impact of the credit on child care facilities. However, we used industry research on the average amount of child care facility expenses that would qualify for the credit to develop a likely range of the financial assistance that the credit would provide. Specifically, we estimate that qualified expenses range from 2 to 8 percent of total facility costs based on industry research from a 2020 IBISWorld Inc., report as well as a 2011 study conducted by Development Research Partners on the economic impact of the Child Care Contribution Credit. Additionally, while expenses can vary greatly for facilities, depending on size, location, age range of children served, and quality level, according to a 2017 economic analysis—*Bearing the Cost of Early Care and Education in Colorado*—conducted by the University of Denver Butler Institute for Families and Brodsky Research and Consulting (a consulting organization that focuses on improving child care systems), a medium-sized provider with five classrooms, in a mid-range cost of living area in the state, is anticipated to have annual expenses of about $600,000 to $790,000, of which 2 to 8 percent would be for costs that are eligible for the credit. Based on these estimates, and assuming that the taxpayer has sufficient tax liability to use the entire value of the credit, the credit would provide a financial benefit of about .4 to 1.6 percent of total facility expenses. Additionally, based on our review of a sample of 29 taxpayers that claimed the credit, which included all taxpayers who claimed more than $5,000 in credits, we found that only four taxpayers had valid claims of $5,000 or more. Overall, in our sample of 29 taxpayers, we found that 12 taxpayers had valid claims for the Facility Owner Investment Credit; their credit amounts ranged in value from $256 to $12,200.

Due to the relatively low use and the small financial impact of the credit, we asked stakeholders who represent, or work with child care facilities, if they were aware of any barriers to claiming the tax credit. According to stakeholders, the most likely reasons that facility owners do not claim the credit are that they are unaware of the credit, or they operate on small profit margins and, therefore, do not have enough tax liability to claim the credit.

PERFORMANCE MEASURE #2: *To what extent has the Employer Facility Investment Credit incentivized employers to provide child care for their employees by making investments in property and equipment more affordable?*

RESULT: Overall, we found that the Employer Facility Investment Credit has not incentivized employers to provide child care facilities for their employees because it is rarely used and may not be large enough to overcome barriers to employers providing child care.

The Department reported that in Tax Year 2018, the most recent year of available data, 14 taxpayers claimed the credit. However, we reviewed documentation submitted by all 14 taxpayers and found that none of them intended to claim the Employer Facility Investment Credit; instead, they appear to have misreported the credit on their returns when attempting to claim other credits, including the Enterprise Zone Contribution Credit and Child Care Contribution Credit. According to stakeholders we interviewed who represent businesses that advocate for employers supporting child care, there are few employers in Colorado that provide child care facilities for their employees and who would, therefore, qualify for the tax credit. These stakeholders told us that many employers do not operate child care facilities for employees because of the upfront investment costs, a lack of appropriate space for the facility, confusion about regulations and perceived legal risk, or leadership disinterest—none of which are addressed through the tax credit. These barriers are not unique to Colorado's tax credit, as research from the National Women's Law Center in 2002 showed that other state employer tax credits for child care are not strong enough incentives to overcome these barriers for many companies, and few, if any, corporations claim the credits. According to stakeholders, employers are more likely to contract with a third party to operate a child care facility, offer employees monthly stipends for child care, or contribute to employee dependent care plans. Thus, it does not appear that the credit is incentivizing employers to provide child care facilities for their employees.

## WHAT ARE THE ECONOMIC COSTS AND BENEFITS OF THE TAX EXPENDITURES?

FACILITY OWNER INVESTMENT CREDIT—Due to taxpayer misreporting, we found that the Department's data on the revenue impact of the credit, which showed $469,346 in credit claims for Tax Year 2018, overstate the true revenue impact. Further, because identifying taxpayers who made reporting errors requires manual review of each taxpayer file, we could not determine the actual impact of the Facility Owner Investment Credit on state revenue due to time constraints. Instead, we used a monetary unit sampling approach for credits claimed for Tax Year 2018 to estimate a likely range of valid credit amounts claimed. Monetary unit sampling allows for the statistical projection of monetary values for a population based on sample results. Using the monetary unit sample which totaled 33 percent of the total credits claimed ($155,373 out of the $469,346 that Revenue reported) and represented 29 taxpayers (all 11 taxpayers claiming $5,000 or more in credits, plus an additional 18 randomly selected taxpayers), we estimate with 90 percent confidence that in Tax Year 2018, the credit resulted in foregone revenue to the State of between $114,458 and $267,164, with the most likely amount being $190,811. We did not have data to show the total amount of investments that child care facilities claiming the Facility Owner Investment Credit made in the same year. However, since the credit is 20 percent of the value of the investments, we estimated that the child care facilities claiming this credit would have invested $954,055 in purchases of property and equipment ($190,811 in credits = 20 percent of $954,055).

Although the fiscal impact of the Facility Owner Investment Credit has been small, this amount could grow in future years if more taxpayers begin taking the credit. As discussed, we found that less than half of the state's 1,200 for-profit child care facilities used the credit, though expenses eligible for the credit include costs that are regularly incurred by child care facilities. According to stakeholders, some eligible taxpayers may not be using the credit due to a lack of awareness, though one industry representative we spoke with indicated that they intend to conduct additional outreach to increase awareness of the credit. Additionally, although we lacked data after Tax Year 2018, child care facilities may have increased spending on qualified property by using COVID-19 grant funds that the federal government and the State have appropriated to stabilize the child care sector and aid in its recovery from the pandemic. Specifically, during the 2020 Legislative Special Session, the General Assembly passed House Bill 20B-1002 and appropriated $44 million to provide grants to child care centers to construct, renovate, or remodel child care facilities. These activities could include the purchase of property and equipment eligible for the 20 percent tax credit. As of January 2022, Human Services awarded $33.8 million to 3,919 facilities to maintain operations and capacity, and another $7.7 million to 180 grantees to open new facilities or expand existing capacity. Additionally, during the 2021 Legislative Session, the General Assembly passed Senate Bill 21-236, creating four additional grant programs for the child care sector, and appropriated $292.5 million in federal funds for child care sustainability grants.

Human Services reported that as of January 2022, more than 4,700 providers are eligible to receive a total of $221.7 million to cover operational expenses.

EMPLOYER FACILITY INVESTMENT CREDIT—Due to taxpayer misreporting, the Department's data, which showed that taxpayers claimed $15,371 in credits for Tax Year 2018, overstate the true revenue impact. Our review of taxpayer files indicates that the credit had $0 revenue impact to the State for Tax Year 2018. Specifically, we manually reviewed data for all 14 taxpayers that claimed the Employer Facility Investment Credit in Tax Year 2018, the most recent year of data available, and found that the taxpayers had intended to claim different credits, like the Child Care Contribution tax credit, but had misreported this on their tax returns. The Department's data from prior years showed that, on average, the Employer Facility Investment Credit resulted in about $10,000 of foregone revenue to the State each year. However, due to time constraints, we were unable to perform additional manual review to evaluate the accuracy of this amount. Therefore, we estimate that this credit had no, or very minimal, revenue impact to the State.

## WHAT IMPACT WOULD ELIMINATING THE TAX EXPENDITURES HAVE ON BENEFICIARIES?

FACILITY OWNER INVESTMENT CREDIT—If the credit were eliminated, child care facilities that buy qualified property and equipment and generate enough revenue to owe state income taxes would no longer receive the financial relief the credit offers. However, because of the low use of the credit, and the small percentage of total operating costs that facilities typically have for qualifying property and equipment (between 2 and 8 percent), eliminating the credit would have a relatively small impact on reducing the costs of licensed, for-profit child care facilities. Based on the monetary unit sample we reviewed, we found that the 12 taxpayers with valid claims were able to claim credits from $256 to a maximum of about $12,200.

Although the credit typically has a relatively small impact for child care facility owners (about .4 to 1.6 percent of total expenses), it is possible that eliminating it could be detrimental to individual facilities and the children they care for, as well as to the child care industry in Colorado. In particular, eliminating the credit could have a substantial impact on facilities that plan to make large investments in eligible equipment in a particular year. Additionally, eliminating the credit could cause facilities to delay purchases and upgrades, purchase lower quality and less expensive property and equipment, or reduce their overall spending on things like materials, food, or staff wages to compensate for the additional income tax they would owe. Any of these changes in spending could result in a lower-quality experience for the children in the facilities.

Additionally, stakeholders we interviewed reported that, currently, even large facilities that typically have higher profit margins are operating on tighter margins and are relying on loans to cover payroll expenses and other operating costs, which have increased due to the COVID-19 pandemic. Therefore, eliminating the credit would remove a financial support that could be important for some child care facilities.

EMPLOYER FACILITY INVESTMENT CREDIT—Eliminating the Employer Child Care Facility Investment Credit would likely have little to no impact on current beneficiaries because few employers provide eligible child care facilities for employees and the credit is rarely used, if at all. However, it is possible that employers will begin to use this credit in the future if other incentives motivate them to offer child care. For example, during the 2021 Legislative Session, the General Assembly passed Senate Bill 21-236 and appropriated $8.7 million to provide grants to employers to construct, renovate, or remodel child care facilities. These activities could include the purchase of property and equipment eligible for the 10 percent tax credit. According to Human Services, four employers qualified and were awarded grant funds; three of these employers are creating new child care programs for their employees. As of January 2022, the Human Services has about $5.6 million available for a second round of applications.

## ARE THERE SIMILAR TAX EXPENDITURES IN OTHER STATES?

In addition to Colorado, we identified two other states that offer tax expenditures that are similar to the Facility Owner Investment Credit and 13 other states that offer tax expenditures similar to the Employer Facility Investment Credit, although there is variation in how the tax expenditures operate.

FACILITY OWNER INVESTMENT CREDIT—Louisiana and Nebraska both offer tax credits to increase the availability of affordable and quality child care as part of a broader package of credits aimed at ensuring school readiness for children. However, unlike Colorado, the credits are based on the states' child care facility quality rating systems; facilities with higher quality ratings are eligible to receive larger tax credits. Louisiana and Nebraska also provide credits based on how many children a facility serves that are part of a child care subsidy program, such as the Child Care Assistance Program, or a foster care program. Louisiana also offers child care facility employees a refundable tax credit, based on their credentials and level of education. For example, Louisiana offers a credit of up to $3,000 for staff at the highest quality rated centers.

EMPLOYER FACILITY INVESTMENT CREDIT—There are 13 states that offer tax credits to employers to invest in child care for employees, and three of these states make their credits refundable. In general, these tax credits apply to a broader range of costs and are larger than Colorado's credit, but range from 3.9 to 75 percent of eligible costs, though some states put a cap on the total dollar amount an employer can claim, such as a fixed amount per taxpayer (e.g., $25,000), a percentage of the employer's income tax liability (e.g., no more than 50 percent), or a statewide maximum (e.g., $3 million). Some of these states offer multiple child care-related tax credits. Specifically,

- 11 states offer credits for employers prior to when the facility is operating. Specifically, four states—Connecticut, Illinois, New York, and Virginia—offer credits for facility planning and preparation costs as well as facility acquisition, construction, and/or renovation. An additional seven states—Georgia, Kansas, Louisiana, Mississippi, Oregon, Rhode Island, and South Carolina—offer credits for facility acquisition, construction, and/or renovation.

- 11 states offer employer tax credits for child care facility operating expenses. For example, eight states—Georgia, Kansas, Illinois, Mississippi, New Mexico, New York, Rhode Island, and South Carolina—provide credits for purchases of materials and supplies, staff wages, maintenance costs, and rental expenses, in addition to equipment costs.

- 10 states—Connecticut, Georgia, Kansas, Louisiana, Mississippi, New Mexico, New York, Oregon, Rhode Island, and South Carolina—offer tax credits to employers that contract with a third party to operate a child care facility for their employees, provide financial subsidies to their employees to purchase child care services, or provide resource and referral services for their employees to locate child care.

A 2002 study from the National Women's Law Center on the use and impact of tax credits to incentivize employers to support child care found that, across states, credits that have lower credit limits, cover a lower percentage of expenses, or are limited to a narrow range of expense types are weaker at incentivizing employers. In contrast, credits that combine a variety of qualifying types of expenses with a large credit percentage and/or no monetary cap tend to provide stronger encouragement for employers to establish child care facilities. However, no states had high usage of their employer child care investment tax credits. While we do not have data to assess current usage rates across other states, Colorado's tax credit does not cover as many qualifying expenses and is a much smaller percentage of employer expenses than other states' credits.

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

Statute provides the following tax expenditures, which similar to the Child Care Facility Investment Credits, provide financial support to child care facilities, employers, and families:

CHILD CARE CONTRIBUTION CREDIT [SECTION 39-22-121, C.R.S.]—This credit provides an income tax credit of up to 50 percent of the total value of a monetary contribution to "promote child care in the state." The credit is limited to $100,000 and taxpayers cannot claim a refund for any excess amount over their income tax liability, but any unused credit amount may be carried forward for up to 5 years. 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.

Contributions must be given without receiving services in exchange (i.e., parent tuition payments to a facility are not eligible.) According to Department of Revenue regulations, this does not prohibit a company from making contributions to a child care facility and claiming the credit, if the facility provides discounted child care to the company's employees [Section 39-22-121(9)(e), 1 CCR 201-2]. However, stakeholders representing employers stated that, generally, employers avoid claiming the Child Care Contribution Credit under these circumstances due to the ambiguity of whether the employer is receiving services in exchange for the contribution. We published an evaluation of this tax credit in September 2021, which found that the Child Care Contribution tax credit has a revenue impact of about $30.8 million annually, with a median benefit to taxpayers of $333. This tax credit is set to expire effective January 1, 2025.

COLORADO WORKS PROGRAM EMPLOYER CREDIT [SECTION 39-22-521(1), C.R.S.]—This credit allows employers to claim a credit against their income taxes equal to 20 percent of their annual expenditures for certain benefits, including child care services, they provide to employees who receive public assistance under the Colorado Works Program, a federally funded program that is designed to help low-income families with children achieve economic self-sufficiency. We published an evaluation of this tax credit in January 2022, and found that few employers use this credit and it was unclear if any employers claimed it specifically for child care expenses.

CHILD CARE EXPENSE CREDIT AND LOW-INCOME CHILD CARE EXPENSE CREDIT [SECTIONS 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 credits are based off the federal Child and Dependent Care Tax Credit, which allows a credit for expenses paid for the care of a qualifying dependent in order to enable the taxpayer to work, or seek out work. Both of these credits allow taxpayers to claim a refund if the credit exceeds their state income taxes, as follows:

- The Child Care Expense Credit allows taxpayers who have an adjusted gross income of $60,000 or less and who claim the federal Child and Dependent Care Tax Credit to claim up to 50 percent of their federal credit amount on their state income tax, up to $525 for a single child or $1,050 for two or more children.

- The Low-Income Child Care Expense Credit allows taxpayers who have an adjusted gross income of $25,000 or less, but who 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.

We published an evaluation of these credits in January 2019, which found that the revenue impact was about $5 million. We found that for Tax Year 2016, the most recent data available during our review, the average benefit of the Child Care Expense credit was $101 and the average benefit of the Low-Income Child Care Expense credit was $391.

CHILD TAX CREDIT [SECTION 39-22-129, C.R.S.]—Allows a refundable state tax credit for taxpayers with children under 6 years old equal to a percentage of the federal credit allowed, which is scaled based on a family's adjusted gross income. In 2021, the General Assembly passed House Bill 21-1311 that, beginning in Tax Year 2022, allows taxpayers who have an eligible child, but who do not meet the IRS eligible child criteria and cannot claim the federal credit, to still claim the state credit.

In addition to state tax credits, federal regulations provide for two employer-based child care tax credits:

CREDIT FOR EMPLOYER-PROVIDED CHILD CARE FACILITIES AND SERVICES [26 USC 45F]—To encourage businesses to provide child care to their employees, the federal government offers companies a tax credit for 25 percent of qualified child care expenditures and 10 percent of qualified child care resource and referral expenditures, up to $150,000. Qualified expenditures for this tax credit are broader than the state tax credit, and include costs associated with acquiring, constructing, or rehabilitating property as well as operating costs such as staff wages and training. Employers may also claim the tax credit if they contract with a third party licensed child care program that provides child care, on or off-site, for employees. However, it appears most employers do not provide child care, or, if they do, they have not taken advantage of this tax credit. According to the 2018 IRS Corporation Income Tax Returns report, the most recent available, the aggregate credit amount claimed by active corporations (excluding S-corporations, real estate investment trusts, and regulated investment companies) was an estimated $16.5 million, making it about 0.04 percent of the aggregate $45.9 billion in general business credits claimed by such corporations for the year.

DEPENDENT CARE ASSISTANCE PROGRAM [26 USC 129]—Employers can provide direct payments to employees or child care providers to cover the cost of child care, which can include child care that the employer provides. In addition to these payments being a business expense, which reduces the business's taxable income, up to $5,000 in payments are excluded from the employee's wages, and therefore, are not taxable to the employee. However, these expenses cannot be used to claim child care expenses tax credits (i.e., Child and Dependent Care Credit).

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

GRANTS FOR CHILD CARE SECTOR—During the 2020 Special Session and the 2021 Legislative Session, the General Assembly passed two bills to support the child care sector in recovering from the impacts of the COVID-19 pandemic. Specifically, House Bill 20B-1002, created two emergency relief grant programs to provide financial support to licensed child care providers. As of January 2022, Human Services had awarded $33.8 million of the $34.8 million appropriated to 3,919 grantees for sustainability grants for facilities to maintain operations and capacity, and awarded $7.7 million of the $8.8 million appropriated to 180 grantees to cover the costs for opening a new facility or expanding existing capacity.

In addition, to increase the capacity of quality early childhood education, Senate Bill 21-236 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 through the Colorado Child Care Assistance Program (CCCAP).

- Community-based programs that cover tuition subsidies or scholarships, employer-based cost sharing, ensuring equitable access for all children, and strengthening child care business practices that improve early childhood outcomes.

As of January 2022, Human Services reported that it was in the award process for the employer-based child care facilities grants and had selected four grantees and intends to open a second round of applications. Human Services reported it will be opening the remaining three grant programs for applications in 2022. Appropriations for these grants totaled $8.7 million for the employer-based child care facilities grants, and $323 million for the remaining three grants.

COLORADO CHILD CARE ASSISTANCE PROGRAM (CCCAP)—Human Services administers CCCAP, which provides child care assistance to families with incomes at or below 185 percent of the federal poverty level and are employed, looking for work, or enrolled in an education program. CCCAP is funded with state general funds, federal block grant funds, and local county funds, and reduces the cost of child care for families. According to a Colorado Health Institute study, the Colorado Shines Brighter, Birth through Five Needs Assessment, in 2019, about 40 percent of licensed child care providers had a fiscal agreement with Human Services to accept children enrolled in CCCAP. The study also estimates that this program serves about 8 percent of the families that are eligible due to funding limitations, available providers, and family barriers to enrollment and affordability. In Fiscal Year 2020, CCCAP provided about $116.5 million in financial assistance to families to reduce the cost of child care for about 26,500 children.

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 located in public schools, child care centers, community preschools, or Head Start programs. According to the Department of Education, in Fiscal Year 2020, the CPP budget was about $128.1 million, to serve up to 29,360 students statewide. According to a Department of Education analysis, this number represents about 38 percent of the eligible children in 2020.

In 2019, the Committee for Economic Development, a nonprofit and nonpartisan policy research center, released a report on Child Care in State Economies, which showed that in 2016, the most recent year of data available, an estimated 18 percent of child care industry revenue in Colorado came from federal and state child care assistance programs, such as CCCAP and CPP; Colorado ranks 45th in terms of the percentage of child care revenue that comes from federal and state assistance programs. In addition, according to *Bearing the Cost of Early Care and Education in Colorado*, these publicly funded programs do not provide enough assistance such that all businesses could serve the amount of families that need subsidized care, nor do the reimbursement rates incentivize businesses to incur additional costs that increase the quality of a child care center.

## WHAT DATA CONSTRAINTS IMPACTED OUR ABILITY TO EVALUATE THE TAX EXPENDITURES?

When we reviewed taxpayer data for Tax Year 2018, the most recent data available, we found that many taxpayers who had claimed the Child Care Facilities Investment Credits had submitted documentation showing that they intended to claim different tax credits, such as the Child Care Contribution Credit or Enterprise Zone Contribution Credit. These filing errors did not impact state revenue, but did impact the accuracy of the Department's data on credits claimed under the Child Care Facility Investment Credits. Because of this, for the Facility Owner Investment Credit, we could not determine how many of the 538 taxpayer claims were valid and used a sampling approach to provide an estimate of its revenue impact to the State. For the Employer Facility Investment Credit, only 14 taxpayers claimed the credit in Tax Year 2018, so we were able to review all of the claims manually.

When we shared information on the taxpayer reporting errors we found with Department , staff said that in some cases, when a variety of different credits are allowed in relation to a similar activity, taxpayers may accidently claim a credit on the incorrect line of their tax form. While the Department performs reviews on the accuracy of income tax returns, and had identified and corrected some of the misreporting errors for the Child Care Facility Investment Credits, those corrections do not fix the reported totals for prior tax years. In order to collect data that are more accurate for future tax years, the Department said staff will reach out to tax practitioners and the developers of tax preparation software to advise them on the differences between the credits and the errors that have occurred.

## 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 FACILITY INVESTMENT CREDITS. As discussed, statute and the enacting legislation for the credits do not state the purposes of the credits or provide performance measures for evaluating their effectiveness. Therefore, for the purposes of our evaluation, we considered a potential purpose for each credit.

FACILITY OWNER INVESTMENT CREDIT—To provide financial assistance to child care facilities by making property and equipment more affordable in order to help facilities stay open.

EMPLOYER FACILITY INVESTMENT CREDIT—To incentivize employers to provide child care facilities for their employees by making property and equipment for the facility operations more affordable.

We identified these purposes based on the statutory language about the credits and their operation, as well as from review of legislative testimony recordings and feedback from stakeholders. We also developed performance measures to assess the extent to which the credits are meeting these potential purposes. However, the General Assembly may want to clarify its intent for the expenditures by providing a purpose statement and corresponding performance measure(s) in statute. This would eliminate potential uncertainty regarding the purpose of the credits and allow our office to more definitively assess the extent to which the credits are accomplishing their intended goal(s).

THE GENERAL ASSEMBLY MAY WANT TO REVIEW THE EFFECTIVENESS OF THE CHILD CARE FACILITY INVESTMENT CREDITS AND COULD CONSIDER EITHER REPEALING THEM OR MAKING CHANGES TO INCREASE THEIR IMPACT. As discussed, we found that the Facility Owner Investment Credit, which is limited to for-profit child care facilities, is not used by most of these facilities and typically provides a relatively small amount of financial support for those that do use it. Additionally, we found that there are few employers providing childcare facilities for employees and that no eligible employers used the Employer Facility Investment Credit in Tax Year 2018. Therefore, the General Assembly could consider repealing the credits.

However, stakeholders indicated that the Facility Owner Investment Credit, which we estimate provided about $190,811 in credits statewide in Tax Year 2018, ranging from $256 to $12,200 per taxpayer, could be an important support for child care facilities in the state. Additionally, we found research indicating that many child care providers in the state are operating on small profit margins, which likely impacts the availability of child care in Colorado. Therefore, if the General Assembly wants to continue to provide these tax credits to offer financial assistance to the child care sector to support the availability of child care, it could consider the following changes to allow greater access to the credits as well as to complement current statute and child care funding programs:

- ALLOWING ADDITIONAL EXPENSES TO BE ELIGIBLE. Operating costs, such as staff salaries and wages are the largest driver of child care facility costs, but are currently not eligible for the credits. Additionally, startup costs, like the costs of purchasing property or facility construction are not included. We found 13 states allow credits for employer-provided child care facilities based on facility start-up costs and/or for operating costs such as materials, supplies, rent expenses, and staff wages; nine states allow both startup and operating expenses; and four states allow either start-up costs or operating expenses

- CREATING TIERED CREDIT LEVELS FOR TYPE OF CARE. According to the 2019 Colorado Shines Brighter, Birth through Five Needs Assessment, the largest area of need for parents in Colorado is for infant care; however, infant care requires additional staffing, equipment, and safety measures, which drive up operating costs. Data from Child Care Aware of America, as of 2017, shows that the cost for infant care ranged from about $10,500 up to $15,000, which is not affordable for many families. However, current subsidies, such as CCCAP, may only cover part of the cost of care leading to a shortage of quality infant care. Therefore, the General Assembly could consider modifying the current credit to offer more assistance for the most costly types of care that are the most in demand.

- MAKING THE CREDITS REFUNDABLE. Because the credit is not refundable, only child care facilities that generate a profit would receive financial assistance when they invest in qualified property and equipment. However, many child care facilities operate on very small profit margins, or sometimes at a loss, and cannot use the credit, or claim the full value of the credit, even though these are facilities that likely need the most financial assistance. According to a 2017 economic study conducted jointly by the University of Denver Butler Institute for Families and Brodsky Research and Consulting (a consulting organization that focuses on improving child care systems), Bearing the Cost of Early Care and Education, in Colorado, "Across all regions, providers struggle to make ends meet, especially at higher quality levels, where expenses far exceed revenues from tuition and public subsidies." One way to address this issue is to modify the credit so that it is refundable so facilities can still receive some financial assistance even if they do not owe income tax. As discussed, we found that three of the 13 states we identified with similar credits make the credits refundable.

- OFFERING BROADER EMPLOYER CREDITS. According to research from the National Women's Law Center from 2002 on employer child care facility tax credits, the administrative burden and liability of operating a child care center are major barriers for employers, and the existing tax credits are not enough to incentivize employers to offer child care and, therefore, do not increase availability or affordability of care. Stakeholders we interviewed reflected the same concerns and said that there are few employers in Colorado that provide child care because of these barriers. Broadening the credit to include employer costs to provide on- or near-site care contracted through a third party, child care stipends to employees, or contributions to dependent care assistance plans would likely make the credit more attractive to employers considering providing child care assistance to employees. We found that 10 of the 13 states with similar credits offered broader employer credits that included these types of expenses.

Although these changes would increase the availability of the credits, it is also important to note that they could substantially increase the credits' revenue impact to the State and we lacked information necessary to estimate this.