OREGON CENTER FOR PUBLIC POLICY

Executive Summary

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March 1, 2001

Addressing the High Cost of Child Care:
House Bill 2716, Making the Working Family Child Care Credit Refundable

by Charles Sheketoff and John Lewis

Child care affordability is of great concern to many working families with children. The need for parents to find accessible, quality care at a reasonable cost has urgency today. Many single-parent families have been leaving or have been diverted from welfare for work, and from the late 1970s to the late 1990s the share of working families with children who were poor doubled to one out of seven and the number of hours Oregon households work increased.

In 1997, the Oregon Legislative Assembly created the Working Family Child Care Credit in an attempt to address the significant impact child care costs have on low-income Oregonians. Amended in 1999, the law now provides a tax credit equal to up to 40% of child care costs for families with incomes up to 200% of poverty ($29,260/year for a family of three in 2001). The credit phases out as a family's income increases from 200 percent to 250 percent of the federal poverty level.

The Working Family Child Care Credit is "non-refundable." A family may not receive the credit amount that exceeds the family's tax liability. Families with high child care costs relative to their income (and tax liability) do not receive the full credit established in the law. For this reason, the credit provides substantial relief from child care costs only in theory. In practice, the credit provides little relief for families at the lowest income levels. As it is currently constructed, the Working Family Child Care Credit is regressive over most of the income range. The real rate of the credit (the percentage of child care costs reflected in the credit received) generally increases along with income. Legislation is pending, House Bill 2716, that would make the credit refundable.

The Oregon Working Family Child Care Credit recognizes one of the most daunting challenges faced by low-income working families with children – the ability to afford child care. The credit can provide direct relief for the high cost of child care, a substantial item in almost 50,000 low income working families' budgets. Making the credit refundable as proposed by HB 2716 will get the benefits to those most in need. Families with high child care costs relative to their income will for the first time receive the full benefit of the Working Family Child Care Credit.

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Child care affordability is of great concern to many working families with children. Three factors give this issue urgency. First, the number of hours Oregon households work increased over the last 20 years.[1] Second, one of the goals of welfare reform was to move the parents of dependent children, primarily single women, into the workforce. As a result of welfare reform, many single-parent families have been leaving or have been diverted from the cash assistance program for work.[2] Third, and perhaps most importantly, from the late 1970s to the late 1990s the share of working families with children who were poor doubled. More than one in seven working families with children was still in poverty in the late 1990s.[3] The need for parents to find accessible, quality care at a reasonable cost has increased given the growth in poverty among workers, the move of single parents off cash assistance, and the increasing time spent at work.

In the most recent market rate study conducted for the Department of Human Services, researchers found that the statewide market rates[4] ranged from $350 per month for a school aged child in a family care setting, to $650 for an infant in group home care.[5] The median rates were not substantially lower, ranging from $330 for a school-aged child in family care to $540 for an infant in a child care center.

The Oregon Progress Board has noted that the cost of child care relative to household income impacts families more than the absolute cost of care. In *Oregon Shines II*, the Progress Board cited data from the Employment Department showing that 59 percent of households earning less than $25,000 per year spent more than 10 percent of their income for child care, while 11 percent of households with incomes of $45,000 or more spent more than 10 percent of their income on child care. The Progress Board concluded that "affordability concerns are greatest in lower income households."[6]

In 1997, the Oregon Legislative Assembly created the Working Family Child Care Credit (WFC) in an attempt to address the significant impact child care costs have on low-income Oregonians. The law provided a tax credit equal to up to 40% of child care costs. As originally enacted, families with incomes up to 200 percent of the federal poverty level qualified for the credit; the maximum credit went to families with incomes up to 150 percent of the federal poverty level.[7] In 1999 the Legislative Assembly expanded the credit, making it available to any family with an income up to 250 percent of the federal poverty level, starting in tax year 2001. The maximum credit—40 percent—is available to any family with income up to 200% of the federal poverty level.[8]

The Working Family Child Care Credit is “non-refundable.” In other words, a family may not receive the credit amount that exceeds the family’s tax liability. Families with high child care costs relative to their income (and tax liability) do not receive the full credit established in the law. For this reason, the credit provides substantial relief from child care costs only in theory. In practice, the credit provides little relief for families at the lowest income levels – those families the credit was designed to help the most. This paper examines the effect of the current “non-refundable” policy and discusses the benefits and costs of making the Working Family Child Care Credit refundable.

Legislative History.

There has been considerable interest in making the credit refundable. Created in 1997, the measure began as a refundable credit in SB 1143-A. The Senate sent the refundable measure to the House with a unanimous 30-0 vote.[9] Twenty-nine days later, the Senate sent the House a second refundable version (SB 388-A), with an earlier effective date, with a 26-3 vote.[10] The earlier effective date placed the measure in the budget debate. Legislative leadership later determined that there was not enough revenue given other spending priorities to enact the measure;[11] the legislature trimmed the cost by making the credit non-refundable.

After the 1997 session, the Senate President asked the Commission for Child Care to convene a Child Care Financing Task Force to study child care affordability issues. The task force concluded that, as designed, the Working Family Child Care Credit did not provide adequate relief to low-income families. The task force recommended the credit be made refundable.[12]

Governor Kitzhaber’s Tax Review Technical Advisory and Policy Advisory Committees also studied the tax credit as a part of their review of Oregon’s tax system during the 1997-99 interim. The Technical Advisory Committee found that the non-refundable tax credit is “of limited use to low-income taxpayers.”[13]

The Policy Advisory Committee subsequently recommended that the legislature make the Working Family Child Care Credit refundable.[14]

The 1999 Legislative Assembly had another opportunity to make the credit refundable. Senate Bill 2 passed the Senate and expanded the income eligibility provisions of the credit, with the maximum credit becoming available for taxpayers with income up to 200 percent of poverty, and the credit phasing out at 250 percent of poverty. The House, on a 49-9 vote, amended the bill to make the credit, with its original income eligibility limits, refundable. The final version of the bill that emerged from conference committee, however, reverted to the Senate version.

The votes in 1997 and 1999 in support of a refundable Working Family Child Care Credit have put a majority of the 2001 Legislative Assembly on record in support of making the credit refundable. Thirty-two members of the House, 17 Republicans and 15 Democrats, have previously voted in support of making the credit refundable.[15] Nineteen members of the Senate, 10 Republicans and 9 Democrats, have previously voted in support of making the credit refundable.[16] Given likely support by some new legislators, there is no apparent political obstacle to enacting refundable credits during the 2001 legislative session. Legislation is pending: House Bill 2716 would make the credit refundable.

Proposals to change the tax credits must consider two issues: who will benefit and what are the costs? Doing nothing and keeping the credits non-refundable maintains the current costs of the credits, while still providing some tax relief to many low-income working families, though not to the most in need and not to the extent provided by the legislation. As shown in the following sections, making the tax credit refundable provides the greatest benefit to those at the lowest income levels—those most in need of assistance in meeting the high cost of child care.

The Structure of the Working Family Child Care Credit.

A family must keep track of its child care costs throughout the year to take advantage of the Working Family Child Care Credit. When the family files their tax forms, they compare the family size and income to Working Family Child Care Credit tables in the Oregon tax forms instruction booklet. These tables give the “rate” of their child care tax credit based on the family’s income in relation to the federal poverty level. The family multiplies the total child care costs by the credit “rate” to determine the total tax credit. For example, a single parent with two children and an annual income of $18,720 (about $9 per hour at full-time work) would qualify for the maximum 40 percent credit because their income is less than 200 percent of poverty. If that family had $8,400 in child care expenses (two children in full time care at $350 per child per month) for the year, the family would qualify for a Working Family Child Care Credit of $3,360.

However, most families claiming the credit will not receive its full value because the credit is “non-refundable.” Most families will only receive as much credit as they owe in taxes.

Figure 1. Oregon Working Family Child Care Credit, Rates

	Tax Year		
	2000	**2001**	**Credit Rate**
Income, as a percentage of the federal poverty level	up to	up to	
	150%	200%	40%
	160%	210%	36%
	170%	220%	32%
	180%	230%	24%
	190%	240%	16%
	200%	250%	8%
	over 200%	over 250%	0%

Figure 2 gives a hypothetical example. Annie Mae is a single parent with two children, earning $9 per hour at full-time work and incurring $8,400 in child care costs over the course of the year. Annie Mae owes $522 in taxes before taking into consideration the Working Family Child Care Credit.[17] Annie Mae’s Working Family Child Care credit is worth $3,360 (40 percent of $8,400). Because the Working Family Child Care Credit is not refundable, however, she will not receive the full value of the credit. Instead, she will receive the credit only to the extent of her tax liability, or $522. If the credit were made refundable, the Mae family would receive a refund check of $2,838, money to provide relief from the high cost of child care relative to her income. Annie Mae is denied the $2,838 in support the legislation was intended to provide.

Figure 2. The Mae family

Annie Mae is a single mother of two children, five year old Jim and seven year old Jan. She makes $9.00 per hour. She works full time and has been in her position for the entire year. Her total income is $18,720. She has $8,400 per year in child care costs.

Adjusted Gross Income	$18,720
Oregon Standard Deduction	-$2,640
Taxable Income	$16,080
Total Taxes Owed	$1,095
Subtract the Oregon Personal Exemption Credit	-$432
Taxes Owed	$663
Subtract the Oregon Earned Income Credit	-$141
Taxes Owed	$522
Working Family Child Care Credit (40% rate)	-$3,360
Taxes Owed	$0
Value of Child Care Credit Lost	**$2,838**

Source: OCPP Analysis

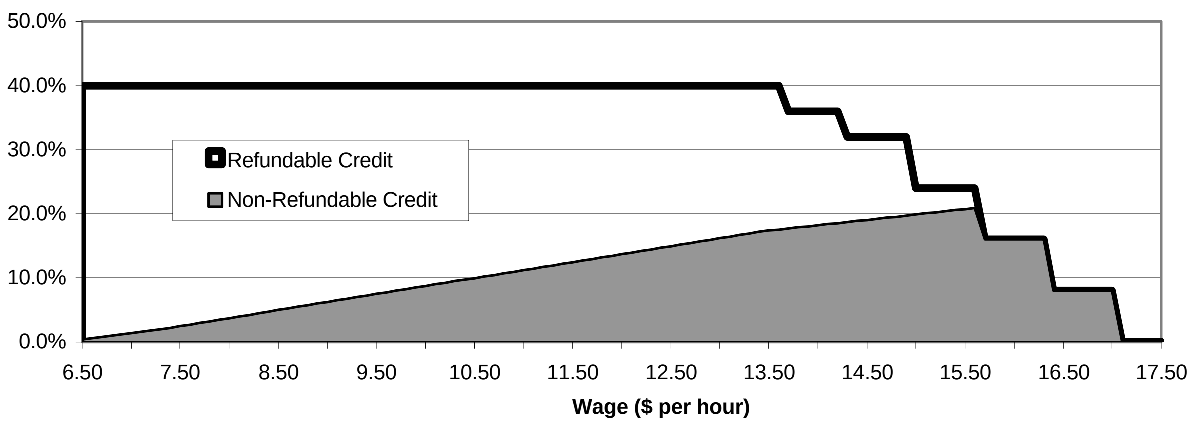
Not all families are like the Maes, of course. Annie Mae is a single mother working a full time job. In the Figure 2 scenario, Annie Mae pays for the full time care of both of her children. To avoid the high cost of child care, some families will explore alternatives such as free care by relatives or part-time work. Nevertheless, making the child care credit refundable would still help many of these families. If the Mae family's child care expenses were only half of what they are in Figure 2, the family would still not fully benefit from the Working Family Child Care Credit because it is non-refundable. A refundable credit would put $1,158 more in their pockets.

As it is currently constructed, the Working Family Child Care Credit is regressive over most of the income range. The real rate of the credit (the percentage of child care costs reflected in the credit received) generally increases along with income. Put another way, as currently constructed the state gives a bigger subsidy to people who have less need for the subsidy due to higher income; families with higher incomes get a bigger subsidy from the state. Figures 3 and 4 illustrate this effect.

Figure 3 assumes a full-time worker in a one-parent, two-child family, with child care expenses equal to the statewide market rate for two school-aged children in full-time family day care settings ($8400) . A minimum wage ($6.50 per hour) family receives a subsidy equal to 0.4 percent of their child care costs, while a family earning $15.50 per hour receives a subsidy worth 20.7 percent of their child care costs. The minimum wage family receives a credit of $34, while the family earning $15.50 per hour, with the same child care costs, receives $1,742, or 51 times the subsidy of the minimum wage family. Families with high child care costs relative to their income never get the full benefit of the credit because it is non-refundable.

Figure 3. Effective Rates - Refundable vs. Non-Refundable Working Family Child Care Credit

(assumes one-parent, two-child family with $8,400 per year in child care expenses)



Source: OCPP Analysis.

Figure 4. Table of Effective Rates and Amounts from Figure 3

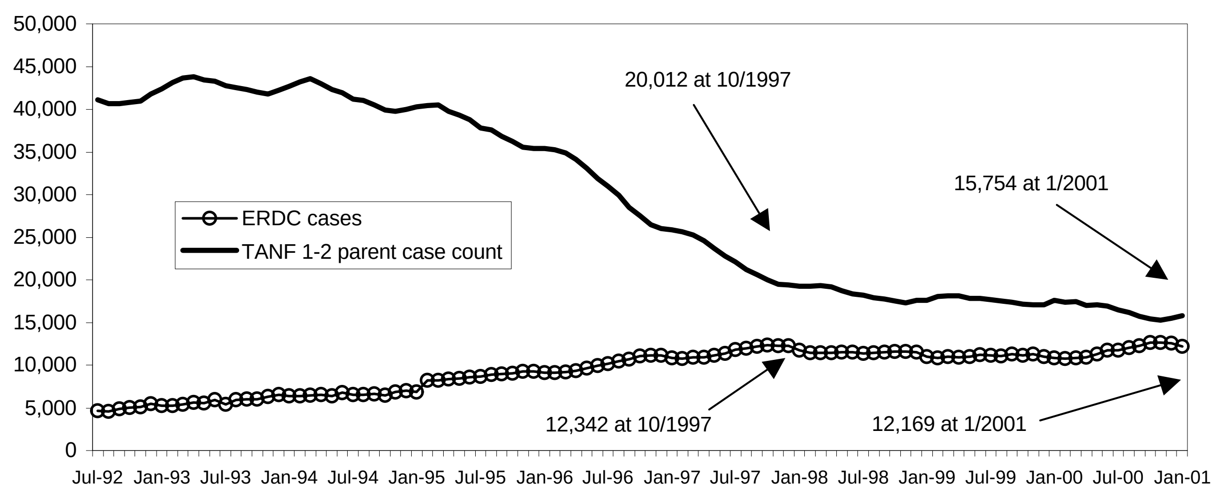
Wage	$ 6.50	$ 7.50	$ 8.50	$ 9.50	$ 10.50	$ 11.50	$ 12.50	$ 13.50	$ 14.50	$ 15.50	$ 16.50	$ 17.50
Statutory Rate	40%	40%	40%	40%	40%	40%	40%	40%	32%	24%	8%	0%
Statutory Credit Amount	$ 3,360	$ 3,360	$ 3,360	$ 3,360	$ 3,360	$ 3,360	$ 3,360	$ 3,360	$ 2,688	$ 2,016	$ 672	$ 0
Actual Rate Received	0.4%	2.5%	5.0%	7.5%	9.9%	12.4%	14.9%	17.4%	19.0%	20.7%	8.0%	0.0%
Actual Credit Received	$ 34	$ 208	$ 418	$ 627	$ 836	$ 1,045	$ 1,254	$ 1,458	$ 1,599	$ 1,742	$ 672	$ 0

A family with $8,400 in child care costs does not receive the full value of the credit until that family's income reaches the equivalent of about $15.70 per hour. At that level the family is only eligible for a 16% credit because their income is between 230 and 240 percent of poverty.

Child Care Subsidies.

Oregon's child care subsidy program, Employment Related Day Care (ERDC) is available to working families with incomes below 185 percent of poverty and with children under the age of 13.[18] Working families are required to share the expense of the child care through a "co-payment." The size of the co-payment increases with the family's income. Many expected the program to increase in size in proportion to the decline in welfare caseload; this has not been the case,

Figure 5. Number of TANF Cases and Number of ERDC Cases



Source: OCPP presentation of AFS data (TANF cases are 1 and 2 parent cases) however. As shown in Figure 5, as of January, 2001, 12,169 families were using the ERDC program, approximately the same number as had been in the program three years earlier when there were 4,258 more families on public assistance. Despite a 21 percent decline in the TANF caseload from October, 1997 to January, 2001, the number of families enrolled in the ERDC program did not change.[19]

Families in ERDC are eligible for the Working Family Child Care Credit to offset their co-payments, and would receive additional assistance if the credit were made refundable. Their need for the credit will increase if the Governor's proposed budget for the ERDC program is enacted. The Governor's budget makes children age 12 ineligible for the subsidy, raises the co-payment costs of most of the families, and reduces the income eligibility level to 160 percent of poverty, making many families ineligible for the program.

Refund versus Carry Forward.

Some who oppose refundability argue that tax credits should not exceed tax liability (the amount of tax owed). Some tax credits, such as the personal exemption credit, are designed to offset tax liability. The Working Family Child Care Credit, on the other hand, is designed to offset work-related costs (child care), not tax liability. Thus, the success of the credit should be measured by its ability to offset the targeted cost (child care), instead of its ability to reduce the recipients' taxes.

The argument that credits in general should not exceed tax liability ignores the fact that many of Oregon's tax credits, including many business credits and the Child and Dependent Care Credit,[20] provide credits that exceed tax liability through the use of "carry forward" provisions. Taxpayers are allowed to "carry forward" unused portions of the credits into the next tax year and beyond. Under carry-forward provisions, any portion of a credit not used in a particular year because of insufficient tax liability can be used in later years, typically a three- or five-year period.

While this may be an attractive alternative for some credits, carry-forward provisions are inappropriate for low-income credits such as the Working Family Child Care Credit for three principle reasons. First, low-income families need the credit income to meet current work-related expenses. The Working Family Child Care Credit was created out of recognition that low-income families have a difficult time meeting the child care expenses work requires. A carry-forward provision denies use of the credit near the time the expenses are incurred. The soonest a carry forward provision can be used is one year later, if it is ever used.

Second, carry-forward provisions only work well where the expense is either not recurring or will be diminishing during the carry-forward time frame, or where the income of the taxpayer increases to incur substantially increased tax liability. A family leaving welfare for work, at an average starting wage of $7.57 per hour,[21] will not have the luxury of waiting several years to utilize the full value of the child care credit. Already they must wait until they file tax returns to receive the available tax relief. If the family's child care costs do not go down, or if their income (and therefore tax liability) does not rise significantly, the family would be unable to utilize a carry-forward provision. Like the non-refundable credit, the promise of the credit would never materialize.

Third, carry-forward provisions place a burden on low-income families to keep more complicated tax records, and they make tax filing more difficult. The complications add administrative burdens for the taxpayer and for the state revenue department, and they increase the possibility of filing errors.

How Much Does it Cost?

Improving the credit is not without costs. The most current estimate from the Legislative Revenue Office (LRO) is that making the credits refundable beginning in tax year 2001 (i.e., for returns due April 15, 2002) would cost $14.1 million in the 2001-03 biennium. This estimate is conservative in that it assumes a high utilization rate by potentially eligible families. Oregon has approximately 49,000 working families with children under age 13 and incomes below 250 percent of poverty who pay for child care.[22] This compares to just 17,800 using the credit in 1998, the most recent year for which data is available.[23] The LRO estimate assumes that about 40,000 families will use the credit in 2001 through 2003, or about 81 percent of those likely to be eligible for the credit. The participation rate for the federal earned income credit (EIC) provides a useful comparison. The federal EIC has been in place for 25 years, is well known and relatively simple to apply for, and enjoys an 86 percent participation rate. Should HB 2716 be enacted later this year, it is unlikely that 81 percent of those eligible will file in the first few years.

Conclusion.

The Oregon Working Family Child Care Credit recognizes one of the most daunting challenges faced by low-income working families with children – the ability to afford child care. The credit can provide direct relief for the high cost of child care, a substantial item in almost 50,000 low income working families' budgets. As noted in the *Tax Expenditure Report 2001-03*, "The credit could be more successful if it were refundable."[24] Making the credit refundable as proposed by HB 2716 will get the benefits to those most in need. Families with high child care costs relative to their income will for the first time receive the full benefit of the Working Family Child Care Credit.

Endnotes.

1 *Prosperity in Perspective: The State of Working Oregon 2000*, Oregon Center for Public Policy, September, 2000, p. 17-18.

2 See, e.g., *Prosperity in Perspective,* p. 48.

3 *Prosperity in Perspective,* Chapter 3.

4 "Market rate" is defined by federal law and agency practice as the rate at the 75th percentile. In other words, at the market rate a person should be able to purchase 75 percent of the child care in the market.

5 Grobe, Deana & Pratt, Clara. *2000 Oregon Child Care Market Rate Study*. Prepared for the Adult and Family Services Division, Oregon Department of Human Services. Oregon State University Family Policy Program, Corvallis, Oregon, September 2000. Monthly figures are for those child care facilities reporting monthly rates.

6 *Oregon Shines II: Updating Oregon's Strategic Plan, A Report to The People of Oregon,* Oregon Progress Board, January 21, 1997, pg. 87.

7 1997 Oregon Laws Chap. 692

8 ORS 315.262, 1999 Oregon Laws. Chap. 998.

9 Senate vote on SB 1143-A, May 1, 1997.

10 Senate vote on SB 388-A on May 30, 1997.

11 The measure included both the Working Family Child Care Credit and the state Earned Income Credit. Both were refundable in the Senate-passed measures.

12 *Child Care Affordability Recommendations,* Oregon Commission for Child Care, presentation to the Senate Interim Revenue and School Finance Committee, September 23, 1998.

13 *Review of Oregon's Tax System: Governor's Tax Review Technical Advisory Committee,* June 1998, pg. 44.

14 *Review of Oregon's Tax System: Policy Recommendations*, January 1999, pp. 55-56.

15 Rep. Vic Backlund, Rep. Tom Butler, Rep. Jim Hill, Rep. Bob Jenson, Rep. Tim Knopp, Rep. Jeff Kropf, Rep. Jerry Krummel, Rep. Jeff Kruse, Rep. Karen Minnis, Rep. Rob Patridge, Rep. Lane Shetterly, Rep. Mark Simmons, Rep. Bruce Starr, Rep. Max Williams, Rep. Carl Wilson, Rep. Jackie Winters, Rep. Bill Witt, Rep. Chris Beck, Rep. JoAnn Bowman, Rep. Richard Devlin, Rep. Dan Gardner, Rep. Gary Hansen, Rep. Elaine Hopson, Rep. Deborah Kafoury, Rep. Al King, Rep. Randy Leonard, Rep. Kathy Lowe, Rep. Jeff Merkley, Rep. Bill Morrisette, Rep. Diane Rosenbaum, Rep. Kurt Schrader, Rep. Vicki Walker

16 Sen. Gene Derfler, Sen. Verne Duncan, Sen. Ted Ferrioli, Sen. Bill Fisher, Sen. Gary George, Sen. Lenn Hannon, Sen. Steve Harper, Sen. Tom Hartung, Sen. Randy Miller, , Sen. David Nelson, Sen. Lee Beyer,

Sen. Kate Brown, Sen. Ginny Burdick, Sen. Susan Castillo, Sen. Ryan Deckert, Sen. Joan Dukes, Sen. Avel Gordly, Sen. Cliff Trow,, Sen. Mae Yih.

[17] This is Annie Mae's tax liability after utilizing the personal exemption and earned income credits.

[18] As noted in the text below, the Governor's Recommended Budget proposes to lower income eligibility for the ERDC program to 160 percent of poverty, to limit its availability to children under 12, and increase co-payments for most of the 12,000 families. These changes will take place early in the next biennium starting July 1, 2001.

[19] As noted in Figure 5, the number actually declined slightly from 12,342 families to 12,169 families. This decline is despite program rule changes intended to make the program more attractive to low income, working families, including an expansion of the income eligibility limits and reduced co-payment levels.

[20] The Child and Dependent Care Credit is different from the Working Family Child Care Credit and is not designed for or generally used by low-income families.

[21] AFS Quarterly Performance Update for the period ending September 2000.

[22] OCPP analysis of Oregon Population Survey and March Current Population Survey data.

[23] 2001-03 Tax Expenditure Report, pg. 140.

[24] Ibid.