DAVID Y. IGE
GOVERNOR

PANKAJ BHANOT
DIRECTOR

CATHY BETTS
DEPUTY DIRECTOR

STATE OF HAWAII
DEPARTMENT OF HUMAN SERVICES
P. O. Box 339
Honolulu, Hawaii 96809-0339

March 26, 2018

TO: The Honorable Representative Sylvia Luke, Chair
House Committee on Finance

FROM: Pankaj Bhanot, Director

SUBJECT: **SB 2905 SD2 HD1 – RELATING TO ON-SITE EARLY CHILDHOOD FACILITIES**

Hearing: Wednesday, March 28, 2018, 2:00 p.m.
Conference Room 308, State Capitol

DEPARTMENT'S POSITION: The Department of Human Services (DHS) appreciates the intent of the bill to expand capacity and access for Hawaii's families to early childhood facilities, and provides comments. DHS is the regulatory authority for all licensed and registered child care facilities and homes statewide, and currently does not have staffing or current IT infrastructure to implement this proposal as drafted and without an appropriation.

Currently, the major priority of the DHS Child Care Program Office is to assure that the state is in compliance with the Child Care and Development Block Grant of 2014 (CCDBG) by the end of 2018. CCDBG is the source of $22 million in federal funds for operating costs for child care regulation (licensing and registration), child care subsidies for low-income working families, and funds to improve the quality of child care.

DHS respectfully requests: 1) that since it does not have tax related expertise DHS not be named the regulating entity of these tax related provisions to determine whether the employer, which may not be the operator of the early childhood facility, qualifies for an income tax credit, and 2) the effective date be set after December 31, 2019 or later to give DHS appropriate time to make any necessary program changes and develop administrative processes.

PURPOSE: The purposes of this bill are to establish an income tax credit for employers who create on-site early childhood facilities and to establish and appropriate funds for one on-site early childhood facility coordinator.

The Senate Committees on Education, Labor, and Human Services amended the measure, per Standing Committee Report Number 2502, by:

(1) Clarifying the use of the term 'qualified costs' throughout the measure;
(2) Exempting employers who close an early childhood facility before the minimum of ten years from credit recapture if the Department of Human Services certifies that the employer closed the facility for reasonable cause;
(3) Inserting a blank annual aggregate cap for the on-site early childhood facility tax credit;
(4) Inserting an effective date of July 1, 2019; and
(5) Making technical, nonsubstantive amendments for the purposes of clarity and consistency.

The Senate Committee on Ways and Means further amended the measure, per Standing Committee Report Number 2777, by:

(1) Clarifying that "qualified costs" refer to expenses incurred in acquiring, constructing, and establishing qualified on-site early childhood facilities;
(2) Clarifying the Department of Human Services' duties with regard to certifying qualified on-site early childhood facilities and verifying taxpayers' qualified costs;
(3) Requiring that taxpayers seeking to claim the tax credit submit information regarding their costs to the Department of Human Services;
(4) Clarifying the provisions regarding the aggregate cap amount of the tax credit;
(5) Clarifying the provisions regarding the refundable nature of the tax credit;
(6) Changing the effective date to July 1, 2050, to facilitate further discussion on the measure; and
(7) Making technical, nonsubstantive amendments for the purposes of clarity, consistency, and style.

The House Committees on Education and Labor and Public Employment further amended the measure, per Standing Committee Report Number 1412-18, by:

(1) Clarifying provisions regarding the aggregate cap on the income tax credit to include a process of certification and enforcement;

(2) Clarifying that an on-site early childhood facility must be completed and certified before a taxpayer can claim the income tax credit; and

(3) Making technical, nonsubstantive amendments for clarity, consistency, and style.

The primary focus of DHS child care licensing (CCL) program is on the health and safety of all children in care. DHS has regulatory authority under Part VIII of chapter 346, Hawaii Revised Statutes (HRS), for the minimum health and safety standards for approximately 1,000 licensed and registered child care facilities and homes statewide.

As part of the child care safety measures, DHS CCL licensing staff collect fingerprint samples and conduct comprehensive background checks, including state and federal fingerprint checks, state and national sex offender registry checks, child abuse and neglect registry check, and adult abuse perpetrator checks, for individual working at or living in child care facilities and homes, including providers who are legally exempt from regulation and are caring for a child whose family receives a child care subsidy from DHS.

As required by the federal Child Care and Development Fund (CCDF) block grant, by the end of calendar year 2018, DHS expects to start monitoring an additional estimated 1,000 non-relative providers, who are legally exempt from regulation and are caring for a child whose family receives a child care subsidy from DHS, for minimum health and safety standards that are being established by DHS. CCL staff also investigates complaints regarding possible illegal child care operations or regulated providers who are in violation of the child care statutes or other administrative requirements.

DHS respectfully requests that the Committee designate another entity to establish the criteria and administrative rules to determine whether the employer, which may not be the operator of the early childhood facility, qualifies for the proposed income tax credit. The department's expertise and jurisdiction lies in determining the current status of the child care facility's license; it does not have regulatory experience, subject matter expertise, or IT infrastructure to address most of the provisions of Section 2 of the proposed measure.

DHS would be able to provide another entity with the information as to the status of the child care facility's license upon request from another entity in order for the entity to determine if the licensure requirement is met to be eligible for the tax credit. However, please consider even this additional responsibility would add an administrative process as well as operational costs.

If the proposed bill were to pass as drafted, DHS requests that the effective date for Section 2 of this measure shall apply to taxable years beginning after **December 31, 2019** or later, instead of the proposed December 31, 2018, as the department's current program demands and efforts are focused on compliance for continued receipt of approximately $22 million in federal CCDF grants. Section (k) on page 8, lines 12-13, would also need to be revised to be "this section shall not apply to any amount paid or incurred before January 1, <u>2020</u>."

The proposed bill would require DHS to develop new administrative rules, operational processes, require additional staffing for DHS, including consultation with subject matter expertise, and additional funds for operations to implement the bill.

DHS respectfully requests that any appropriations and positions provided under this bill does not adversely impact the priorities identified under the Governor's supplemental budget request.

As referenced above, DHS is the regulatory agency of the state's child care system codified in statute in Part VIII, Chapter 346, HRS. The department points out that the term "early childhood facility" proposed in this measure does not fall under the child care definitions established under section 346-151, HRS. If the intent of the bill is for the tax credit only to be applicable when an employer establishes on an on-site group child care center, which includes both infant and toddler child care centers and group child care centers (i.e. preschools), then the bill should be amended to reference "group child care centers," as defined under section 346-151, HRS, rather than using the term "early childhood facilities" which is currently not defined.

The proposed subsection (c) (2), on page 4, line 3, indicates that DHS shall "[v]erify the amount of qualified costs." DHS respectfully requests that any review of qualified costs to acquire, construct, establish, and operate a group child care center be submitted to an entity that has expertise to review these kinds of capital improvement and fiscal documentation. DHS does not have the kind of expertise to determine whether expenses incurred are <u>legitimate</u> costs involved in acquisition, construction, and establishment of a child care facility and any associated operating costs. If DHS were to procure the expertise through a consultant contract, DHS requires an appropriation to do so.

The proposed subsection (f)(2), on page 6, lines 5-15, indicates that "provided that the credit shall not be subject to recapture if the department of human services certifies that the employer ceased operating the facility for reasonable cause, including but not limited to going out of business, being forced to close the facility due to a natural disaster or other unforeseeable circumstances, and closing the facility temporarily with the intention of reopening it for a reason such as facility refurbishment or improvement." The measure is unclear as to what other kinds of 'unforeseeable circumstances' would be acceptable to force the facility to close and still allow the tax credit to be claimed. There are also circumstances that are foreseeable, such as the revocation of the license by DHS due to serious violations of health and safety standards that could be an acceptable reason to close the facility. DHS respectfully requests the Legislature to clarify if revocation is a reasonable cause to cease operating the group child care center and still allow the tax credit to be claimed.

Thank you for the opportunity to provide comments on this measure.

DAVID Y. IGE
GOVERNOR

DOUGLAS S. CHIN
LIEUTENANT GOVERNOR

LINDA CHU TAKAYAMA
DIRECTOR

DAMIEN A. ELEFANTE
DEPUTY DIRECTOR

STATE OF HAWAII
DEPARTMENT OF TAXATION
830 PUNCHBOWL STREET, ROOM 221
HONOLULU, HAWAII 96813
http://tax.hawaii.gov/
Phone: (808) 587-1540 / Fax: (808) 587-1560
Email: Tax.Directors.Office@hawaii.gov

To: The Honorable Sylvia Luke, Chair
and Members of the House Committee on Finance

Date: Wednesday, March 28, 2018
Time: 2:00 P.M.
Place: Conference Room 308, State Capitol

From: Linda Chu Takayama, Director
Department of Taxation

Re: S.B. 2905, S.D. 2, H.D. 1, Relating to On-Site Early Childhood Facilities

The Department of Taxation (Department) offers the following comments on S.B. 2905, S.D. 2, H.D. 1, for your consideration.

S.B. 2905, S.D. 2, H.D. 1, creates a refundable income tax credit for employers that operate an on-site early childhood facility. The credit is equal to 25% of qualified costs incurred operating the facility, including acquiring, constructing, and establishing the facility. The bill requires certification of facilities by the Department of Human Services (DHS). The credit is to be claimed against the taxpayer's net income tax liability, and any excess over payments due shall be refunded to the taxpayer. The credit has an aggregate cap of an unspecified amount. H.D. 1 has a defective effective date of July 1, 2050, but the credit is otherwise effective for taxable years beginning, and for qualified costs incurred, after December 31, 2018.

First, the Department notes that it generally prefers nonrefundable credits rather than refundable credits. Refundable credits are more prone to improper claims and abuse.

Second, the Department notes that the House Committees on Education and Labor & Public Employment made multiple changes to this measure at the Department’s request. The Department appreciates the consideration of its testimony.

Finally, the Department is able to administer this new credit for taxable years beginning after December 31, 2018 as currently written.

Thank you for the opportunity to provide comments.

DAVID Y. IGE
GOVERNOR

LAUREN MORIGUCHI
DIRECTOR

STATE OF HAWAI'I
Executive Office on Early Learning
1390 Miller Street, Room 303
HONOLULU, HAWAI'I 96813

March 27, 2018

TO: Representative Sylvia Luke, Chair
Representative Ty J.K. Cullen, Vice-Chair
House Committee on Finance

FROM: Lauren Moriguchi, Director
Executive Office on Early Learning

SUBJECT: **Measure:** S.B. No. 2905, H.D. 1 – Relating to On-site Early Childhood Facilities
Hearing Date: March 28, 2018
Time: 2:00 p.m.
Location: Room 308

Purpose of Bill: Establishes an income tax credit for employers who create on-site early childhood facilities. Establishes and appropriates funds for one On-site Early Childhood Facility Coordinator position.

EXECUTIVE OFFICE ON EARLY LEARNING'S POSITION: The Executive Office on Early Learning (EOEL) supports the intent of S.B. No. 2905, H.D. 1.

EOEL is statutorily responsible for the development of the State's early childhood system, which shall a spectrum of high-quality development and learning opportunities for children throughout the state, from prenatal care until the time they enter kindergarten, with priority given to underserved or at-risk children.

We support the intent of the bill to increase capacity for, and access to, high-quality early learning programs by incentivizing employers to develop on-site facilities. We believe that partnering with the private sector is the most cost-effective, time-efficient means for the State to increase access to early learning opportunities.

Thank you for the opportunity to provide testimony on this bill.

LEGISLATIVE TAX BILL SERVICE

TAX FOUNDATION OF HAWAII
126 Queen Street, Suite 304 Honolulu, Hawaii 96813 Tel. 536-4587

SUBJECT: INCOME, Tax Credit for On-Site Early Childhood Facilities

BILL NUMBER: SB 2905, SD-2, HD-1

INTRODUCED BY: House Committee on Education, House Committee on Labor & Public Employment

EXECUTIVE SUMMARY: Establishes an income tax credit for employers who create on-site early childhood facilities. We are concerned that the credit may be unworkable from the perspective of the certifying agency (DHS) because several of the criteria necessary to establish creditable costs necessarily cannot be satisfied until the facility is built and is operating. Also, from the perspective of the credit recipient, the long recapture period may require the credit to be recognized as a liability on the taxpayer's books, impacting the taxpayer's ability to incur more debt if needed.

SYNOPSIS: Adds a new section to chapter 235, HRS, to establish an on-site early childhood facility tax credit. The amount of the credit is 25% of the qualified costs for acquiring, constructing, and establishing the facility, up to $____ per employer. The credit is refundable.

Defines "qualified costs" as the expenses incurred in acquiring, constructing, and establishing a qualified on-site early childhood facility and the associated operating costs; except for insurance.

Defines "qualified on-site early childhood facility" as an on-site early child hood facility offered by an employer to all employees that is licensed and approved by the department of human services and receives an accreditation from a recognized national early childhood accredited agency within two years of initial operation.

The Department of Human Services is tasked with providing a certificate of approval to the facility. The criteria for approving such a facility is to consider: (1) whether the on-site early childhood facility provides early childhood programs from child care to preschool and junior kindergarten; (2) participation rate by employees; (3) quality of the early childhood programs being provided; and (4) whether the presence of an on-site early childhood facility promotes a healthy workplace environment.

The Department of Human Services is also tasked with certifying tax credit claims, similar to the process in place for the motion picture/television production credit.

Limitations of the credit include: (1) the total credit allowed for an employer in any taxable year shall not exceed $_____; (2) the total amount of tax credits allowed under this section shall not exceed $_____ all taxpayers in any fiscal year; if the total amount of credits claimed is greater, the credit shall be allowed to taxpayers based on the date of certification by DHS on a first come, first served basis, where any taxpayer who is certified by the department of human services in a fiscal year and who is not eligible to claim the credit due to the $_____ having been exceeded for that fiscal year shall be eligible to claim the credit in the subsequent year and shall receive priority for the credit over taxpayers who receive certification in the subsequent fiscal year.

The on-site early childhood facility shall operate for a minimum of ten years or all of the credit taken in the preceding ten taxable years may be recaptured, except if the department of human services certifies that the employer ceased operating the facility for reasonable cause, including but not limited to going out of business, being forced to close the facility due to a natural disaster or other unforeseeable circumstances, and closing the facility temporarily with the intention of reopening it for a reason such as facility refurbishment or improvement. The credit may also be recaptured if the credit was claimed for acquiring, constructing, or establishing a facility that is not certified (approved) by DHS within 180 days of the completion of its acquisition, construction, or establishment.

Every claim, including amended claims, for the tax credit under this section shall be filed on or before the end of the twelfth month following the close of the taxable year for which the tax credit may be claimed. Failure to do so shall constitute a waiver of the right to claim the tax credit.

No other income tax credit may be claimed for the same qualified costs.

EFFECTIVE DATE: July 1, 2050; the credit provisions apply to taxable years beginning after December 31, 2018.

STAFF COMMENTS: This measure is problematic and may be unworkable for several reasons.

- The credit is awarded for "qualified costs," defined as expenses incurred in acquiring, constructing, and establishing a qualified facility. A qualified facility is licensed and approved by DHS, and receives accreditation within two years of initial operation. The criteria for approving the facility include the employee participation rate and the programs offered, neither of which will be known before the facility is constructed. Thus a Catch-22 situation is created.

- The current draft of the bill states that all credit will be recaptured if the credit was claimed for acquiring, constructing, or establishing a facility that is not certified within 180 days. What happens if construction of the facility drags out longer than 180 days? Under this draft of the bill, ALL credit is recaptured.

- Similar to the above point, the statute requires that the facility receive an accreditation from a recognized national early childhood accredited agency within two years of initial operation in order to be qualified. The accreditation necessarily will not be in place before the facility is constructed. If the intent is to provisionally award the credit for construction and acquisition costs, necessarily incurred before the facility is built, subject to later recapture if the facility is not ultimately accredited, the bill needs to say that.

- The statute requires the credit to be claimed within twelve months following the close of the taxable year for which the tax credit may be claimed, or the tax credit is waived.

What is the event that triggers eligibility for the credit? Incurring the construction costs? Obtaining the accreditation from a national accrediting body within two years of first operation? Getting Department of Human Services certification, which must consider the employee participation rate and the programs offered? These events can be expected to occur at widely different times.

- There is a recapture provision stating that the facility must be in place for ten years upon pain of full credit recapture. The Committee may consider allowing the taxpayer to earn the credit ratably over the recapture period in order to allow the taxpayer to use the money (otherwise it may be recognized as a liability on the taxpayer's books and could hurt its credit rating). See, for example, section 235-110.7(d), HRS, which by reference to section 47 of an earlier Internal Revenue Code provides for a three-year recapture period for the Capital Goods Excise Tax Credit and provides for a taxpayer earning one-third of the credit each year, meaning that after the item has been in service a full year, one-third of the credit is not subject to recapture; one full year later, another one-third of the credit is not subject to recapture; and so on.

Digested 3/27/2018

March 28, 2018

To: Representative Sylvia Luke, Chair
Representative Ty J.K. Cullen, Vice Chair
House Committee on Finance

From: Mandy Finlay, Director of Public Policy
Hawaii Children's Action Network

Re: **SB 2905, SD2, HD1 – Relating to On-Site Early Childhood Facilities – SUPPORT**
Hawaii State Capitol, Room 308, March 28, 2018, 2:00 PM

On behalf of Hawaii Children's Action Network (HCAN), we are writing to support SB 2905, SD2, HD1, which would establish an income tax credit for employers who create on-site early childhood facilities.

S.B. 2905 is intended to increase access to childcare for working families by providing a tax incentive to employers who provided on-site childcare facilities. There is a serious shortage of early childhood seats in Hawaii, especially in rural areas and on neighbor islands. In 2017, the University of Hawaii Center on the Family and Hawaiʻi Children's Action Network released the Hawaiʻi Early Learning Needs Assessment.[1] The purpose of the study was to inform strategic planning for early childhood development, care, and learning programs in the state. The study found that overall, there are only enough DHS-regulated childcare seats to care for one out of every four children under the age of 6. The numbers are even worse for infant-toddler care; for every thirty-seven (37) children under age 3, there is only one center-based childcare spot. The islands of Kauai, Molokai, and Lanai have no infant-toddler centers. This measure will increase access to quality childcare and promote more family-friendly work environments.

For the above reasons, HCAN respectfully requests the Committee to support this measure.

HCAN is committed to building a unified voice advocating for Hawaii's children by improving their safety, health, and education.

[1] [1] Debaryshe, B. D., Stern, I., Bellasario, C., Zysman, D., & Bird, O. (2017). *Early childhood programs in Hawaii*. Honolulu: University of Hawaii Center on the Family.

To: Rep. Sylvia Luke, Chair, House Committee on Finance

Rep. Ty J. K. Cullen, Vice Chair, House Committee on Finance

Re: S.B. No. 2905 SD2– Relating to On-site Early Childhood Facilities, March 28, 2018, 2:00 pm., Conference Room 308

Purpose: Establishes an income tax credit for employers who create on-site early childhood facilities. Establishes and appropriates funds for one on-site early childhood facility coordinator position.

Dear Chair Luke, Vice Chair Luke and Members of the House Committee on Finance:

My name is Robert G. Peters and I thank you for the opportunity to testify about SB 2950 SD2. Over the past 10 years, I have served as a member of the Early Learning Task Force, the Early Learning Council and the Early Learning Advisory Board, which is now the Early Learning Board. Although not serving as a spokesperson for the ELB, which has yet to have an opportunity to discuss it, I am personally testifying in support of SB 2950 SD2.

The Early Learning Board is statutorily responsible for directing the Executive Office on Early Learning as it develops the State's early childhood system, which will include a range of high-quality development and learning opportunities for children throughout the state, from prenatal care until the time they enter kindergarten, with priority given to underserved or at-risk children.

Recognizing the critical need for the expansion of access to quality early learning opportunities, I support the intent of the bill to increase capacity for, and access to high-quality early learning programs by incentivizing employers to develop on-site facilities. I believe that partnering with the private sector is the most cost-effective, time-efficient means for the State to increase access to early learning opportunities.

Thank you again for the opportunity to testify in support of SB 2905 SD2.

Sincerely,

Robert G. Peters, EdD