Child Care Expenses Income Tax Credits

Tax Expenditure Evaluation • December 2023 • 2023-TE19

OFFICE OF THE STATE AUDITOR
COLORADO

The Child Care Expenses Credits allow taxpayers to claim a refundable income tax credit for their expenses incurred for child care for children under age 13. Taxpayers must have an Adjusted Gross Income (AGI) of $60,000 or less and must incur the child care expenses to allow the taxpayer to work or look for work. The credits, and qualifying expenses, are based on the federal Child and Dependent Care Expenses Credit (federal credit) that taxpayers can claim on their federal income tax return.

There are two state credits that are available to make child care more affordable for working families:

- The Child Care Expenses Credit for taxpayers that have an Adjusted Gross Income (AGI) of $60,000 or less, for both joint and single filers, and claim the federal Child and Dependent Care Credit on their federal income taxes or,
- The Low-Income Child Care Expenses Credit for taxpayers that have an AGI of $25,000 or less, for both joint and single filers, and are eligible for the federal credit, but do not have sufficient federal tax liability to claim the federal credit.

Overall, we found that both credits are likely underutilized and the Low-Income Child Care Expenses Credit does not ensure that all individuals without a federal tax liability can claim a credit for their child care expenses. Additionally, the credit amounts are likely too small to help taxpayers afford child care to allow them to work or look for work given the current costs of child care. Specifically, we found:

- Only about 14 percent (19,200 returns) of potentially eligible Colorado households claimed the Child Care Expenses credits in Tax Year 2020.
- Changes to federal tax laws, such as increases to the standard deduction amounts, have reduced the number of taxpayers who claim the credits and caused some taxpayers with child care expenses to become ineligible for the credits.
- Credit amounts, averaging less than $300, offset some child care expenses, but are likely too small to make child care more affordable in order for parents to work or look for work.
- AGI limits and allowable expense amounts have not been adjusted for inflation, eroding the relative financial benefit of the credits.

Policy Considerations

- The General Assembly could consider decoupling the state Child Care Expenses Credits from the federal credit.
- The General Assembly could consider adjusting the income limits for the state credits to account for inflation and changes to the standard deduction amount.
- The General Assembly could consider adding the Child Care Expenses Credits to the state requirements that employers notify employees of the availability of certain tax credits [Section 39-22-604(6)(c), C.R.S.].

	Child Care Expenses Credit	Low-Income Child Care Expenses Credit
Tax Type:	**Income**	**Income**
Expenditure Type:	**Credit**	**Credit**
Statutory Citation:	**39-22-119, C.R.S.**	**39-22-119.5, C.R.S.**
Year Enacted:	**1996**	**2014**
Repeal/Expiration Date:	**None**	**December 31, 2028**
Revenue Impact:	**$5.1 million (2020)**	
Purpose given in statute or enacting legislation? **Yes**		

Child Care Expenses Credits

Background

The Child Care Expenses Credits allow taxpayers to claim a refundable income tax credit for expenses they incur for child care for children under age 13.

There are two state credits:

- The Child Care Expenses Credit for taxpayers that have an Adjusted Gross Income (AGI) of $60,000 or less, for both joint and single filers, and claim the federal Child and Dependent Care Credit (federal credit) on their federal income taxes.

- The Low-Income Child Care Expenses Credit for taxpayers that have an AGI of $25,000 or less, for both joint and single filers, and are eligible for the federal credit, but do not have sufficient federal tax liability to claim it.

Eligibility for the two state credits, and qualifying expenses, are based on the federal credit, which requires that taxpayers, and their spouse if married:

- Incur the expenses to care for a dependent in order to work or attend school, or look for work.

- Have earned income for the year (e.g., income from wages, salaries, or tips, but not income from a pension, interest and dividends, or child support payments). If the taxpayer is a full-time student, or one spouse is a full-time student, they are treated as having earned income.

- Have a federal tax liability to apply the credits to.

The federal credit amount is calculated as a percentage of a taxpayer's eligible child care expenses, up to $3,000 in expenses for one dependent or up to $6,000 for two or more dependents. The percentage declines from a maximum of 35 percent of expenses to 20 percent of expenses, as taxpayers' AGI increases. For example, a taxpayer with an AGI under $15,000 can receive a federal income tax credit of 35 percent of their

Technical Note:

IRS Publication 503 defines eligible child care expenses as expenses that "allow you (and your spouse if filing jointly) to work or look for work" and are for "a qualifying person's care."

For the federal credit, qualifying persons are considered to be a dependent under the age of 13, or in some instances a spouse or other dependent, 13 years or older, who could not care for themselves.

Expenses may include daycare, before or after school care, and expenses for summer camps, provided they meet the other conditions. Expenses for education for grades kindergarten and above do not qualify since they are not considered for the "well-being and protection" of the child.

child care expenses, and a taxpayer with an AGI of $43,000 or more can receive a federal income tax credit of 20 percent of their child care expenses.

Child Care Expenses Credit. The state Child Care Expenses Credit was enacted in 1996 and in order for Colorado taxpayers to claim the credit, it requires them to:

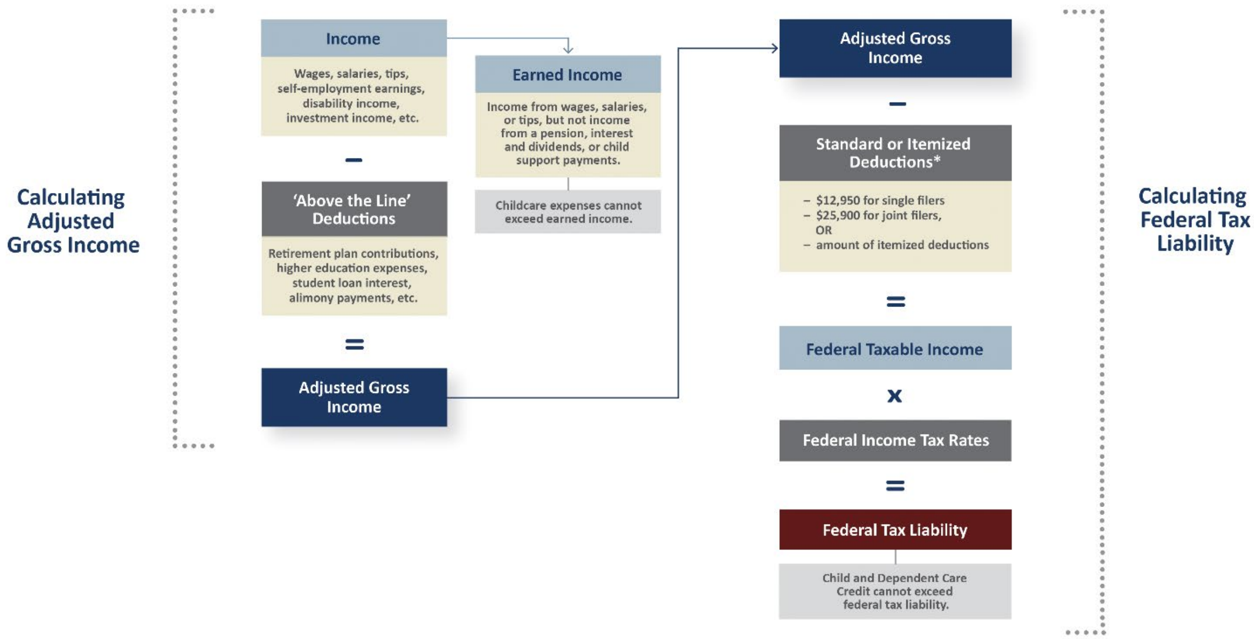
- Claim the federal credit,
- Have an AGI of $60,000 or less,
- Only claim expenses for a dependent under the age of 13 (i.e., the state credits do not apply to some of the federally qualified dependents, such as dependent adults).

Since 2018, the state Child Care Expenses credit allows taxpayers to claim 50 percent of the amount of their federal credit on their state income taxes, up to a maximum of $525 for one dependent or $1,050 for two or more dependents. Prior to this legislative change, the percentage of credits allowed ranged from 50 percent of the taxpayer's federal credit to 10 percent, decreasing as AGI increased.

The purpose of the Child Care Expenses Credit is to "make child care more affordable for working families." The state credit allows taxpayers who are eligible for the federal credit to claim an additional credit on their state income taxes. Therefore, the state credit is limited by the requirements of the federal credit, including the taxpayer's AGI, earned income, their federal tax liability amount, and the federal credit amounts.

There are two main factors when calculating federal income taxes that limit the credit for taxpayers. First, taxpayers cannot claim child care expenses that exceed their earned income, unless they are a student. Second, taxpayers cannot claim a credit that exceeds their federal tax liability. Taxpayers reduce their income by certain deductions to arrive at AGI, which determines 1.) the percentage of their child care expenses they can claim for the federal credit, and 2.) whether they are eligible for the state credits. Taxpayers then reduce their AGI by the standard, or itemized deductions, in order to determine their federal tax liability. Taxpayers with an AGI at or below the standard deduction amount do not have a tax liability and, therefore, cannot claim a federal credit. Exhibit 1 shows how AGI, earned income, and federal tax liability are calculated to determine the amount of federal credits a taxpayer is eligible to claim.

Exhibit 1
Calculation of AGI, Earned Income, Taxable Income, and Federal Tax Liability that Determine Eligibility for the State Child Care Expenses Credits



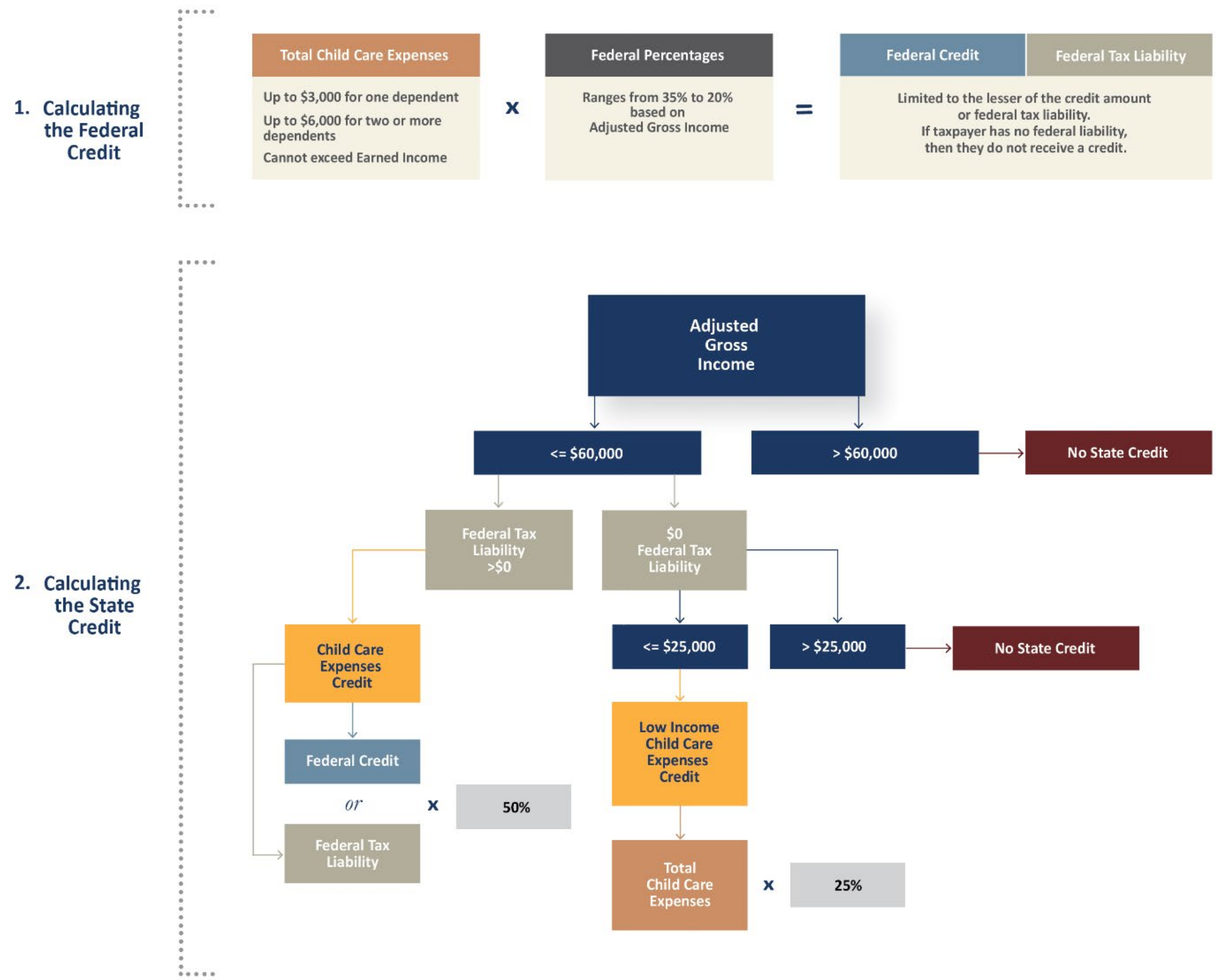
Source: Office of the State Auditor analysis of federal income tax calculation steps.
*Standard Deduction amounts listed are for Tax Year 2022. Itemized deductions include amounts paid for state and local income or sales taxes, real property taxes, personal property taxes, mortgage interest, disaster losses, gifts to charities, and part of the amount paid for medical and dental expenses.

Low-Income Child Care Expenses Credit. Although taxpayers with lower incomes may meet all of the eligibility requirements for the federal credit, many do not have a federal tax liability and, therefore, cannot claim a federal credit. As a result, until 2014, these taxpayers were also not eligible to claim the State's Child Care Expenses Credit. In order to correct this issue, in 2014, the Legislature created the Low-Income Child Care Expenses Credit that allows taxpayers with an AGI of $25,000 or less, who are eligible for the federal credit but do not have sufficient tax liability, to still claim a state credit for their child care expenses. Instead of a percentage of their federal credit, taxpayers can claim a credit for up to 25 percent of their qualified child care expenses, up to a maximum of $500 for one dependent or $1,000 for two or more dependents.

The purpose of the Low-Income Credit is "to fix the [Child Care Expenses Credit] so that all low-income working families are able to claim the [Child Care Expenses Credit] regardless of the amount of their federal child care expenses credit."

Exhibit 2 shows how the federal credit and two state Child Care Expenses Credits are calculated.

Exhibit 2
Calculation of the Federal Child and Dependent Care Expenses Credit and the State Child Care Expenses Credit and Low-Income Child Care Expenses Credit



Source: Office of the State Auditor analysis of the calculation of the federal Child and Dependent Care Expenses Credit and how it impacts the calculation of the State's standard Child Care Expenses Credit and Low-Income Child Care Expenses Credit.

While there are not data providing the exact number of Colorado taxpayers who are eligible for the Child Care Expenses Credits, according to U.S. Census Bureau data, in 2021, there were approximately 141,000 households in Colorado with an annual income of $60,000 or less and at least one child under the age of 13. Of those 141,000 households, there were approximately 42,700 households with an annual income under $25,000.

Research from several nonpartisan economic and policy centers shows that the affordability of child care has a disproportionate effect on low-income earning women and women of color, causing parents to leave the workforce to care for children or for children to go without child care when child care is unaffordable. According to the Colorado Health Institute, much like "access to health care, healthy food, and safe and affordable housing, access to affordable child care affects a family's quality of life and ability to thrive." In addition, subsidies for child care are associated with higher quality child care, which supports child development. The Child Care Expenses Credits are one of several programs in Colorado to financially assist families with the cost of children. In addition to the Child Care Expenses Credits, Colorado has:

- The Child Tax Credit (CTC), which is a refundable credit for taxpayers with children under the age of 6 who also qualify for the federal Child Tax Credit. This credit does not require taxpayers to work or look for work in order to qualify, but is limited to taxpayers with an AGI of up to $75,000 for single filers or up to $85,000 for joint filers, adjusted for inflation. Because the CTC was not funded until 2022, data is not yet available on the use or revenue impact of the credit.

- The Colorado Child Care Assistance Program (CCCAP), which provides financial assistance to low-income families to pay for child care. Using federal block grant funds and state funds, the Department of Early Childhood (CDEC) administers CCCAP with Colorado counties; each Colorado county sets their own eligibility requirements, but families cannot have an income over 85 percent of the state median income, or about $74,500 between 2018 and 2022. In federal fiscal year 2020, CCCAP funding was able to serve about 10,300 families and about 17,000 children. Families may qualify for CCCAP and the state Child Care Expenses Credits, but may not use their CCCAP benefits as qualifying expenses for the credits.

- The Colorado Universal Preschool Program (UPK) to provide free part-time preschool for 3- and 4-year olds. This program began in 2023, therefore some families may have reduced child care expenses if their child attends part-time preschool funded through the UPK program.

In addition to Colorado, 24 other states plus the District of Columbia, offer an income tax credit for child care expenses so that taxpayers may work or look for work.

Statute does not provide performance measures to evaluate whether these credits are meeting their purpose; therefore, we developed the following performance measures to evaluate the credits.

- The extent to which the Child Care Expenses Credits are being claimed by eligible taxpayers.

- The extent to which the Low-Income Child Care Expenses Credit has allowed taxpayers without a federal tax liability to still claim a state tax credit for their child care expenses.

- Whether the Child Care Expenses Credits are making child care more affordable so parents can work or look for work.

Evaluation Results

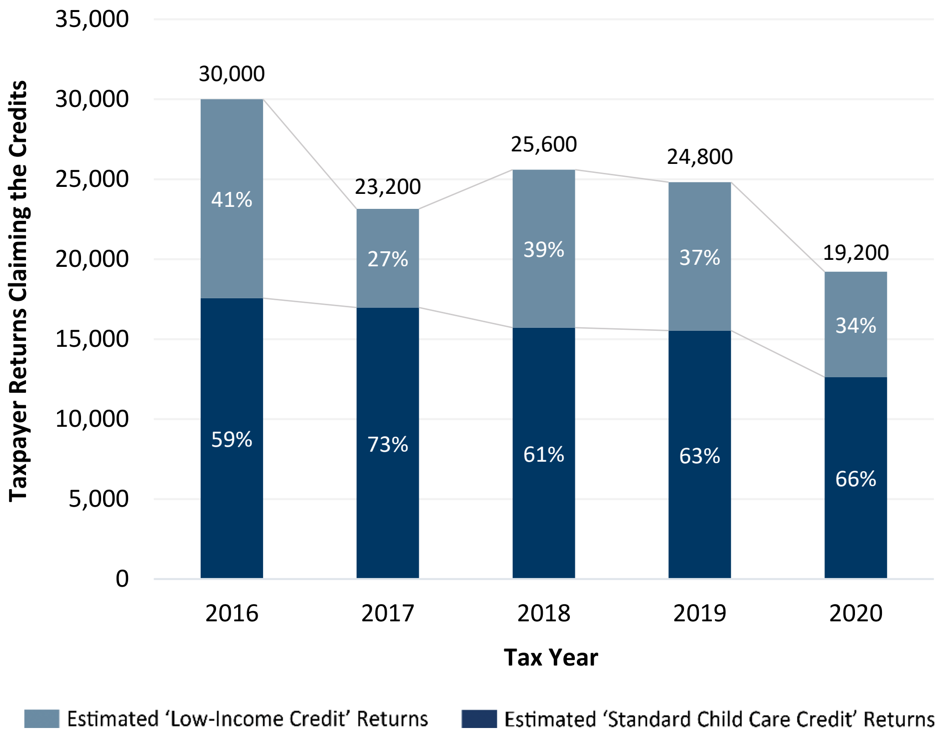
We found that both credits are likely underutilized and the Low-Income Child Care Expenses Credit does not ensure that all individuals without a federal tax liability can claim a credit for their child care expenses. Additionally, the credit amounts are likely too small to help taxpayers afford child care to allow them to work or look for work given the current costs of child care.

Only a small portion of intended beneficiaries have claimed the credits. Based on U.S. Census Bureau estimates, 141,000 Colorado households have at least one child under the age of 13 and have an income of $60,000 or less. We found that only about 14 percent of these households (about 19,200 taxpayer returns) claimed the Child Care Expenses Credits in Tax Year 2020, the most recent year of Department of Revenue (Department) data available. Of the 141,000 households with qualifying children and income levels, there were about 42,700 households with an annual income under $25,000 who may qualify for the Low-Income Child Care Expenses Credit. However, because the Department does not separate out returns claiming the Low-Income Child Care Expenses Credit from the standard Child Care Expenses Credit, we could not determine the extent to which taxpayers claimed each credit. However, based on taxpayer AGI, we estimated that about 15.5 percent (about 6,600 taxpayer returns) of the eligible 42,700 households with an income below $25,000 used the Low-Income Child Care Expenses Credit.

While some of the 141,000 households may be ineligible for the credits because they do not have qualifying child care expenses, or one spouse does not have earned income, it is likely that many qualifying households do not claim the credits. This aligns with research on use of the federal credit. Specifically, a 2021 Congressional Research Service report, *Child and Dependent Care Tax Benefits: How They Work and Who Receives Them*, reported that in 2018, nationwide, about 12 percent of taxpayers with children claimed the federal tax credit.

While state legislative efforts in 2018 to expand the standard Child Care Expenses Credit by increasing the percentage of the federal credit that could be claimed may have temporarily boosted the use of the credit, Exhibit 3 shows that the total number of returns claiming the credits has declined by about 36 percent, dropping from roughly 30,000 in 2016 to 19,200 in 2020.

Exhibit 3
Number of Returns Claiming the Child Care Expenses Credits[1] for Tax Years 2016 through 2020.



Source: Office of the State Auditor analysis of Department of Revenue Statistics of Income and Tax Profile and Expenditure data for taxpayers claiming the Child Care Expenses Tax Credits for Tax Years 2016 through 2020.
[1] The Department of Revenue data for the Low-Income Credit and the standard Child Care Credit is aggregated together as the Child Care Expenses Credits. Therefore the percentage of returns claiming the Low-Income Credit and the Standard Child Care Credit are OSA estimates based on taxpayers' AGI.

The number of claims in 2020 might be particularly low due to the COVID-19 pandemic, which created massive shifts in the child care industry and workforce. It is possible that some of the decrease in use of the credits in 2020 could be attributed to child care facilities being closed, taxpayers relying on informal networks of care, or taxpayers choosing to leave the workforce to care for their children, or losing their job.

While there is not a clear reason why the use of the Child Care Expenses Tax Credits is a low proportion of the potentially eligible population, there are some factors that may be creating barriers to the use of the credits. Research on other similar tax credits, such as the Earned Income Tax Credit and the Child Tax Credit also show that at lower income levels, many taxpayers who are eligible for tax credits do not claim them because they are not legally required to file a tax return. This may be because the small benefit of a tax credit does not outweigh the time and cost of filing a tax return. Among eligible taxpayers that do file, lack of awareness might also be a cause for some taxpayers not claiming the credits. According to stakeholders in the early childhood industry, a lack of awareness could be due to a lack of access to the internet and tax preparation assistance, a lack of community outreach addressing this credit, or informational materials that are not multi-lingual or accessible to taxpayers.

Additionally, a Congressional Research Service report on the federal credit indicates that the lowest-income families tend to have child care expenses well below the $3,000 and $6,000 maximum expense amounts allowed, so they would not receive the maximum state credit either. Lower out-of-pocket child care expenses do not necessarily mean that lower-income populations do not have child care needs; rather, they may indicate that these needs are met informally—such as having a neighbor or relative watch a child during the workday. These informal arrangements may not result in formal out-of-pocket child care payments that allow taxpayers to qualify for the credit.

Technical Note:

As part of the American Rescue Plan Act, for 2021, the federal tax credit expense limits were increased, the percentage of allowable expenses was increased to 50 percent for taxpayers with an AGI of less than $125,000, and the tax credit became refundable.

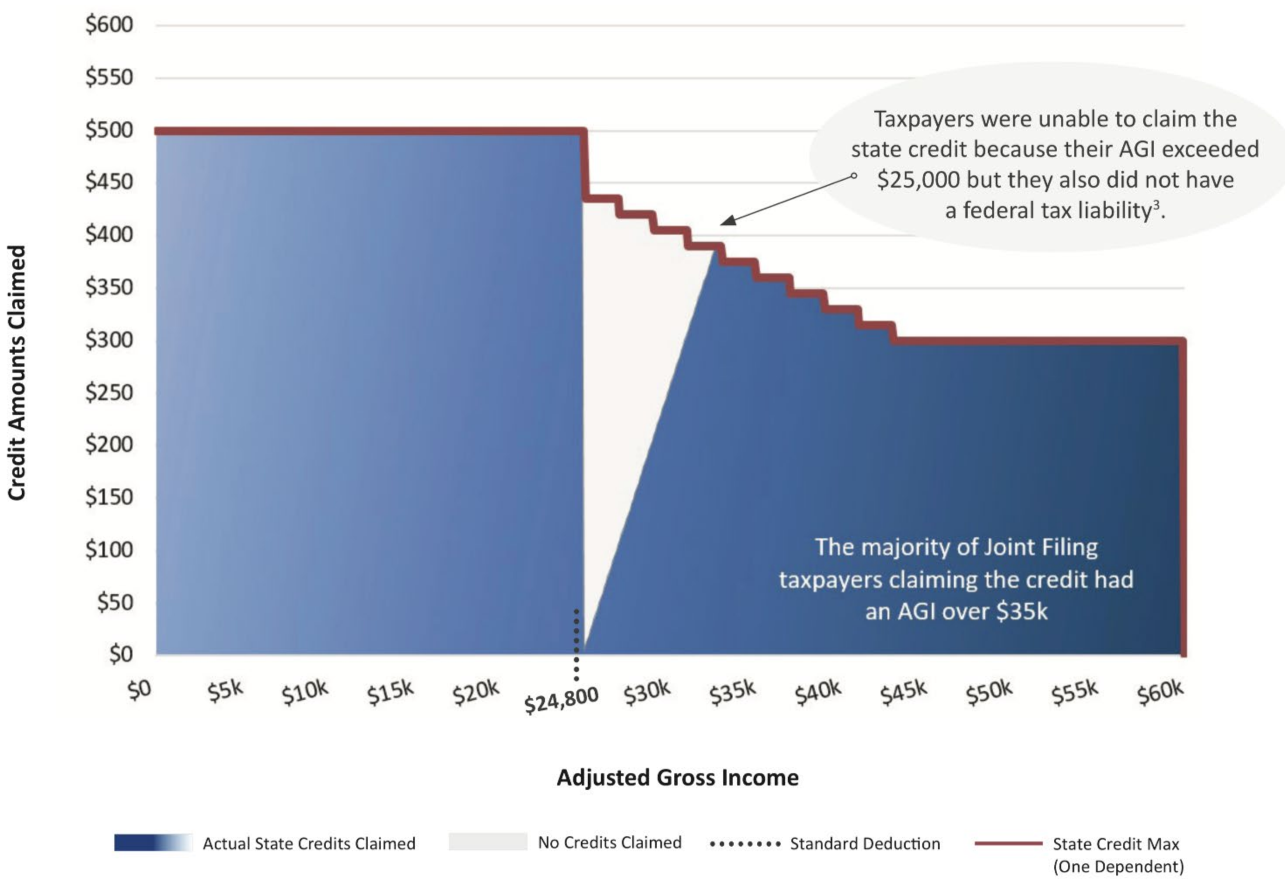
Because of this federal change, the state tax credit amounts will likely increase for Tax Year 2021 since taxpayers could claim a larger percentage of their child care expenses and were not limited to a credit by their federal tax liability.

However, the Department does not have data available for Tax Year 2021 to analyze the impact of the American Rescue Plan Act's temporary changes.

Finally, according to the 2022 Colorado Health Access Survey conducted by the Colorado Health Institute, "about 17% of parents/guardians living at or below 100% of the federal poverty level ($27,750 per year for a family of four in 2022) needed but couldn't find child care in the past year." Therefore, some taxpayers who would otherwise use the credits may have been unable to do so because they could not find child care.

Changes to federal tax laws have reduced the number of taxpayers who can claim the Child Care Expense Credits and caused uneven treatment for certain taxpayers. In 2014, when the Low-Income Child Care Expenses Tax Credit was passed, the standard deduction was $12,400 for joint filers. However, since the passage of the federal Tax Cuts and Jobs Act (TCJA) in 2017, the standard deduction was nearly doubled and the Child Tax Credit was increased, reducing the tax liability of low-income earners, and reducing the number of taxpayers who could claim the federal credit. For example, in 2018 research from the Tax Policy Center estimated that the share of taxpayers with incomes between $20,000 and $40,000 benefiting from the federal credit would fall more than any other income group. If taxpayers at these income levels are not able to claim the federal credit because the standard deduction and other federal tax credits have reduced their tax liability, then they are not able to claim the State's Child Care Expenses Credit. In addition, if these taxpayers who no longer receive a federal credit have an AGI of more than $25,000 they are also ineligible for the State's Low-Income Child Care Expenses Credit. The taxpayers most impacted by these changes are joint filers whose AGI is at, or near, the standard deduction amount. Exhibit 4 shows the impact of the federal changes on taxpayers who are married and filing jointly at an AGI level near $25,000 in Tax Year 2020. As shown, the standard deduction amount in 2020 was $24,800, meaning that taxpayers at or below this amount would not have had taxable income or a federal tax liability and would not be eligible to claim the federal credit, but could still claim the state Low-Income Child Care Expenses Credit. However, taxpayers with an AGI between $25,000 and $33,000 saw their federal tax liability reduced to minimal amounts, or $0, meaning their state credits were limited to 50 percent of their federal tax liability or they were no longer eligible for a state tax credit, shown by the gap in the actual credits claimed in 2020. As taxpayers' AGI increases there was a gradual phase-in of the credit, until taxpayers' federal tax liability exceeded their federal credit amount and they could begin claiming the maximum credit amount.

Exhibit 4
Tax Year 2020[1] Child Care Expenses Credits Claimed[2] for Joint Filing Taxpayers and Maximum Allowable State Tax Credits for One Dependent.



Source: Office of the State Auditor analysis of Department of Revenue data for married filing jointly taxpayers claiming the Child Care Expenses Tax Credits for Tax Year 2020.

[1] In Tax Year 2020, the federal standard deduction reduced taxpayers' federal tax liability and resulted in a gap in eligibility for jointly filing taxpayers to claim the Child Care Expenses Credits. This graph does not show taxpayers with an AGI of less than $0. These taxpayers on average claimed credits of about $550, but accounted for less than 1 percent of the total revenue impact.

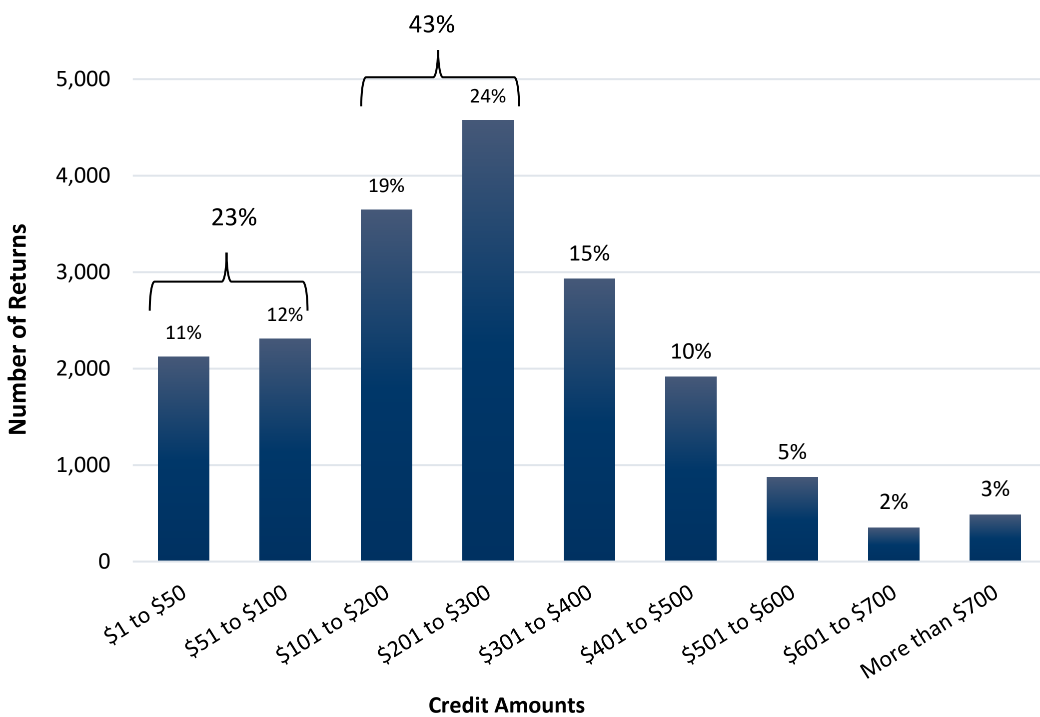
[2] This graph shows the range of credits claimed in 2020, not all taxpayers claimed the maximum amount of the credit. Credits ranged from $1 to $500.

[3] The gap in taxpayers claiming the state credits ranges from an AGI of $24,801 to $32,700 where, based on taxpayers claiming the standard deduction of $24,800 in Tax Year 2020, no other adjustments to income, and an effective tax rate of 10 percent, the taxpayers' federal tax liability exceeds the amount of the tax credit that a taxpayer is eligible to claim.

While the Tax Cuts and Jobs Act provisions are set to expire in 2025, any federal changes that limit taxpayers' tax liabilities could potentially prevent taxpayers from claiming the federal and state credits. For example, the 2023 standard deduction for joint filers is $27,700, which is over the AGI limit for taxpayers with no federal tax liability to claim the state Low-Income Child Care Expenses Credit. As a result, taxpayers who file jointly, claim the standard deduction, and have an AGI between $25,001 and $27,700 will not be able to claim either the state credit or the federal credit in Tax Year 2023. Taxpayers with an AGI just over the standard deduction amount will see their credits reduced because they will have little to no federal tax liability. This gap will continue to grow to the extent that the standard deduction amount increases.

Credit amounts offset some child care expenses, but the credits are likely too small to make child care more affordable. According to Department data, the average amount claimed for both credits was $266 in Tax Year 2020, up from about $100 in Tax Year 2017 due to 2018 legislation that increased the credit amounts. As shown in Exhibit 5, of the 19,200 returns that claimed the credit in 2020, about a quarter of them claimed $100 or less, and nearly half claimed between $101 to $300. Overall the revenue impact of the credits in Tax Year 2020 was about $5.1 million.

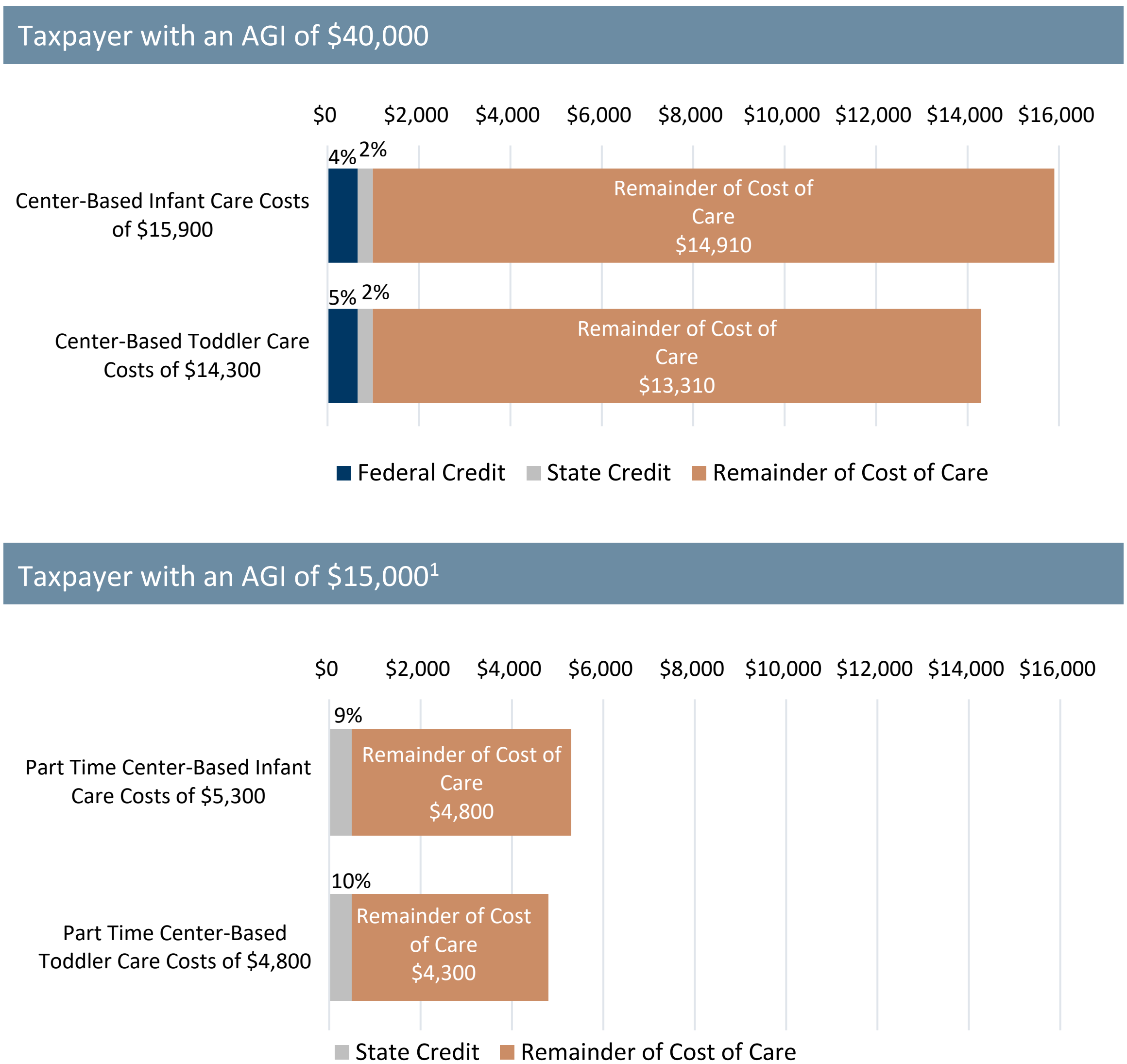
Exhibit 5
Frequency of Dollar Amounts Claimed for Tax Year 2020



Source: Office of the State Auditor analysis of Department of Revenue data for taxpayers claiming the Child Care Expenses Tax Credits for Tax Year 2020. This data includes taxpayers who had expenses for one dependent (maximum credit of $525) or two or more dependents (maximum credit of $1,050).

While taxpayers may also claim a federal credit if they have a federal tax liability, offsetting some additional child care costs, the overall impact of the credits is relatively low in relation to the costs. Exhibit 6 shows a hypothetical example of the costs covered by state and federal tax credits depending on the median child care costs in Colorado for two different types of center-based care, infant care and toddler care, by taxpayer AGI. In 2020, the median annual cost of center-based infant care was about $15,900 a year, and the median costs for center-based toddler care was about $14,300.

Exhibit 6
Portion of Child Care Expenses Covered by State and Federal Credits



Source: Office of the State Auditor analysis of the percent of child care expenses covered for infant care and toddler care for taxpayers claiming the standard Child Care Expenses Credit and the federal credit or the Low-Income Child Care Expenses Credit.

[1] While taxpayers with an AGI of $15,000 or less are eligible for a federal tax credit of 35 percent of their expenses, because they generally do not have a federal tax liability they are unlikely to be able to claim a federal credit and instead would only receive the state Low-Income Child Care Expenses Credit.

While data on the actual expenses incurred for child care compared to the credit is not available, the U.S. Department of Health and Human Services considers child care 'affordable' for families that are low-income and qualify for assistance when it accounts for 7 percent or less of a family's income. In Colorado, families spend an average of between 16 and 27 percent of household income on child care; in the hypothetical example taxpayers receiving the maximum amount of credits would still spend between 29 and 37 percent of their income on child care. Given the relatively small amounts of the state credits, they are unlikely to make childcare significantly more affordable for most families.

Policy Considerations

The General Assembly could consider decoupling the state Child Care Expenses Credits from the federal credit. As discussed above, changes to the federal tax code have had unintended consequences on the eligibility of taxpayers for the Child Care Expenses Credits. As a result, some taxpayers currently do not qualify for a state-level credit or get a smaller credit than appears to have been intended by the General Assembly. Additionally, the relative value of the federal credits has declined because the expense caps used to calculate the federal credit have not been changed since 2001. According to a report from Congressional Research Service, "if the [federal] credit as enacted in 1976 had been adjusted annually for inflation, the $800 maximum credit amount for two or more children in 1976 would have equaled more than $3,500 in 2018. Hence, inflation has eroded a substantial amount of the credit's value." Currently the maximum federal credit for two or more children is $2,100. Additionally, actual expenses for child care have outpaced the maximum allowable expenses. Because the state Child Care Expense Credits are tied to the allowable federal expenses, their relative value has also eroded over time.

The General Assembly could address these issues by amending statutes to base the calculation of the Child Care Expenses Credit on the expenses taxpayers incur, rather than their federal credit. Unlinking the state credit from the federal credit would also allow the State to set its own expense limits and credit rates based on taxpayer AGI. However, this could potentially increase the administrative burden on taxpayers since they would have to calculate a second state credit rather than basing their calculation on their federal credit amount. Additionally, decoupling the credit could create an additional administrative burden for the Department, since coupling the state credit with the federal credit allows the State to benefit from federal oversight and fraud detection. These changes could also have a revenue impact to the State, depending on the requirements the General Assembly sets for calculating the credit amount, but we did not have data to quantify the potential impacts.

Four other states—Hawaii, New Mexico, Oregon, and South Carolina—have their own state child care expenses tax credits that are not linked to the amount of the taxpayer's federal credit; instead these states provide taxpayers a credit based on a percentage of the taxpayer's expenses for child care. Three other states—California, Iowa, and New York—calculate the allowable credit amount based on the taxpayer's federal credit, but allow a state credit regardless of the taxpayer's federal tax liability, similar to how the Low-Income Child Care Expenses Credit operates.

In our previous evaluation in 2019, we also included a policy consideration to decouple the state Child Care Expenses Tax Credit from the federal credit to avoid federal changes that reduce the credit's stability and effectiveness. The General Assembly has not taken action on this policy consideration. However, in the 2023 Legislative Session, the General Assembly did pass House Bill 23-1112, which expanded the benefits of two similar credits that are based on federal credits, the Earned Income Tax Credit, and the Child Tax Credit. This expansion also included restructuring the Child Tax Credit as a flat rate based on taxpayer AGI to allow all taxpayers to claim a credit regardless of the amount of their federal Child Tax Credit.

The General Assembly could consider adjusting the income limits for the state credits to account for inflation and changes to the standard deduction amount. The Child Care Expenses Credits' AGI limits are not adjusted for inflation, and the AGI limit of $60,000 is the same since the credit was created in 1996. According to inflation adjustments from the U.S. Bureau of Labor and Statistics, $60,000 in 1996 is equivalent to about $116,300 in 2023, almost double the original AGI level cut off. Additionally, as discussed, the Low-Income Child Care Expense Credit's AGI limit was set at $25,000 with the intention of allowing taxpayers who did not qualify for a federal credit due to having insufficient income to still qualify for a state credit. Because the federal standard deduction amount has increased substantially, some taxpayers are no longer able to qualify for any state credit or are substantially limited in the amount they can claim due to having insufficient tax liabilities. Therefore, the credits may not be providing the same benefits as originally intended and the General Assembly may want to consider increasing the AGI limit for the Low-Income Child Care Expenses Credit if the credits remain coupled to the federal tax credit.

These changes would likely increase the revenue impact to the State, as more taxpayers would become eligible for the credit and some may be able to claim larger credits, but we did not have data to assess the extent to which the revenue impact would increase.

The General Assembly could consider adding the Child Care Expenses Credits to the state requirements that employers notify employees of the availability of certain tax credits. As discussed, it appears that the credits are underutilized by eligible taxpayers and this could be, at least in part, due to a lack of awareness. In 2023, the General Assembly passed House Bill 23-1006, which requires employers to provide employees with written notice of the availability of other state tax credits, such as the Earned Income Tax Credit and the Child Tax Credit, in English and other languages the employer uses to communicate with their employees. Adding the Child Care Expenses tax credits to the employer requirements could help increase awareness of the credit for taxpayers who may not currently know about the credits and could be eligible for them.

OFFICE OF THE STATE AUDITOR

State Auditor	**Kerri L. Hunter, CPA, CFE**
Deputy State Auditor	**Michelle Colin, JD**
Evaluation Managers	**Trey Standley, JD** **James Taurman, MPA**
Evaluation Supervisor	**Meghan Westmoreland, MBA**

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