New America's Early Education Watch Blog

Guest Post: Using Tax Credits to Promote Quality Early Care and Education

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By Louise Stoney

Nearly every state has, or is developing, an early care and education quality rating and improvement system (QRIS). But many states find that only a small percentage of providers participate and that parents often do not use the system to guide decision-making. Last year Louisiana enacted an innovative tax credit package designed to address these concerns by offering financial rewards for those who participate in Quality Start, the state's new QRIS. Legislation authored by Senator Ann Duplessis, a banker who represents parts of New Orleans, created four separate, refundable School Readiness Tax Credits (SRTC) available to families, child care providers, child care teachers and directors and businesses that support child care.

Quality Start and the SRTC are market-based strategies that aim to achieve multiple goals: encourage all early care and education programs to focus on continuous quality improvement; ensure that low income children and families have access to high quality child care; help early care and education programs keep prices affordable as quality increases; and encourage early care and education teachers and directors to increase their qualifications and attain higher levels of training. The tax package also aims to encourage businesses to invest in early care and education programs that participate in QRIS as well as in child care resource and referral agencies that offer the training and technical assistance providers need to successfully participate.

While quite a few states have included financial incentives in their QRIS, what makes the Louisiana approach unique is its use of the state tax code to provide these incentives.

Here is how it works:

- **Families** with a child under 6 who is enrolled in a child care program that participates in Quality Start will be eligible for a refundable tax credit based on the star rating of the program. The value of the credit increases with higher ratings.

- **Child care providers** that participate in Quality Start are eligible to receive a refundable tax credit based on the number of stars they earn and on the number of children they serve in the Child Care Assistance Program or in foster care. The value of the credit rages from $750 per target child served in a center with two stars to $1,500 per child for a center with five stars.

- **Child care teachers and directors** are eligible for a refundable tax credit if they teach in a center that participates in Quality Start. The credit is based on the level of education the individual has attained, rather than the star level of the program in which she teaches. The value of the credit ranges from $1,500 for a teacher or director at Level I of the Louisiana career ladder to $3,000 for a teacher or director at Level IV of the career ladder.

- **Businesses** that provide financial support to centers that participate in Quality Start are eligible for a credit based on the star rating of the center. Businesses may also receive a tax credit for donations up to $5,000 made to child care resource and referral agencies.

An important strength of the sytem is that most of the tax credits — including those available to teachers and early care and education programs — are refundable. A refundable tax credit is one that is available to taxpayers even if it is greater than their tax liability or if they owe no taxes at all. This means that child care teachers who earn low wages (and therefore pay little or no tax) will receive a wage subsidy each year in the form of a tax refund. The provider tax credit is also refundable, which means that non-profit child care centers may receive what is essentially an annual grant based on their star level and the number of eligible children they serve. For example, a three-star center that serves 10 children who receive a child care subsidy and 10 children in the foster care program would be eligible for a $20,000 tax refund. If the center owed $25,000 in taxes, its tax bill would be reduced to $5,000. If the center was non-profit and did not owe any taxes, it would receive a check for $20,000. Funds from the SRTC are in addition to — not in lieu of — child care subsidy reimbursement.

Using tax credits to encourage expansion and use of high-quality early care and education is an unusual approach, but the strategy offers some unique strengths. First, embedding early care and education policy in the tax code is a potentially powerful way to engage the public. Second, unlike direct public expenditures, which must be re-appropriated each year, tax credits offer more stability. Credits typically remain in effect until they are repealed. Third, the tax system touches nearly every American, making it possible to reach parents and child care teachers that might not feel comfortable going to a public agency to request help or might have difficulty filling out a grant or subsidy application form. Fourth, the tax system has a built-in payment method, reducing the administrative costs that might be incurred when distributing a new government initiative. Additionally, a tax credit strategy can strengthen support for web-based data systems. Tax and revenue departments want to be able to easily verify eligibility for tax credits; having automated systems such as such as Professional Development Registries and QRIS provider databases make it possible to electronically verify compliance by entering a computer code onto the tax form. (For a deeper discussion of these issues see a paper I wrote with Anne Mitchell, "Using Tax Credits to Promote High Quality Early Care and Education Services.")

Effective tax benefits are widely marketed by the industry they seek to engage. The home mortgage tax deduction is a case in point; real estate agents, banks and developers have helped to ensure that potential home-buyers are not only aware of the tax benefit but take it into consideration when making decisions about the home they purchase. This credit has had an impact on consumer behavior. Recognizing that industry and consumer engagement is essential, Louisiana has hired a marketing firm to work with them on a social marketing campaign for both its ratings system and its tax credit. The campaign includes a focus on target audiences and is designed to expand awareness, understanding and participation in the initiatives.

Some national early childhood advocates are concerned that tax credits would be paid for out of the same pool of money used to pay providers directly, leading to a zero sum game. But the Louisiana SRTC is supported by state general fund dollars and thereby actually increases the funds flowing into the child care sector. It does not tap federal Child Care and Development Block grant funds or state education or social service allocations. Indeed, the SRTC was enacted in the same year that the legislature approved an increase in the state's pre-kindergarten program as well as a State earned income tax credit, all of which came from state dollars. Former Gov. Kathleen Blanco included the tax package in the economic development section of her budget message. The initiative was framed as support for small business and followed an economic impact report, conducted jointly by Louisiana State University and Tulane University, that showed how these investments created more jobs and increased income.

It is too early to know how many parents and providers are using the tax credits. (Tax returns claiming the credit were due May 15th of 2009 for the 2008 tax year.) However, a preliminary analysis showed that 1,247 teachers and directors and 73 centers were eligible for them, totaling approximately $3.5 million in tax benefits. In addition, child care resource and referral agencies across the state received approximately $100,000 in donations from businesses who sought to access the business contribution credits. These results are quite promising, given that both SRTC and Quality Start are very new systems and most providers are still at lower star levels.

Tax benefits on their own are an insufficient funding source for early care and education. However, experience from other fields suggests that when combined with other direct investments from government, employers, consumers and the private sector, tax credits offer a promising, market-based incentive for high quality early care and education.

Louise Stoney is the co-founder of the Alliance for Early Childhood Finance.

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