VERMONT LEGISLATIVE

Joint Fiscal Office

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Fiscal Note

May 10, 2023 Joint Fiscal Office Staff

S.56 – An act relating to child care and early childhood education

As further amended by the House Committee on Ways & Means, Draft 8.2[1]

Bill Summary

The bill proposes to establish a Prekindergarten Education Implementation Committee; change the pupil weight for prekindergarten students in districts that offer full day programs in a public school setting from -0.54 to 0; expand eligibility for the Child Care Financial Assistance Program (CCFAP) to families with income up to 575% of the federal poverty level (FPL); increase the rates the State pays early care and education providers; provide payments to providers to address readiness, quality and capacity; and require the Secretary of Human Service to provide a plan for the reorganization of the Department for Children and Families (DCF).

Fiscal Impact

The bill would appropriate $71.4 million in fiscal year 2024 for the following:

- $107,500 to AOE to retain a contractor to assist the Prekindergarten Education Implementation Committee and pay per diem compensation and reimbursement of expenses for eligible members.
- $47.3 million to DCF to expand CCFAP eligibility and increase provider rates.
- $4 million to DCF to administer the adjustments to CCFAP.
- $20 million to DCF for one-time readiness payments to providers.

The bill takes into consideration a combination of one-time and base funding appropriated in H.494 (the "Big Bill") as passed by the House to cover the estimated costs associated with this bill in fiscal year 2024.[2] Annualized and other anticipated costs are estimated to be $130.5 million in fiscal year 2025.

The following sections of the bill as amended by the House Committee on Ways & Means would have fiscal impacts. See the chart on the last page for a summary of the appropriations and revenues in the bill as amended.

Prekindergarten Education Implementation Committee

Section 2 – Prekindergarten Education Implementation Committee

Sec. 2 would create the Prekindergarten Education Implementation Committee to assist the Agency of Education in improving and expanding accessible, affordable, and high-quality prekindergarten education

[1] https://legislature.vermont.gov/Documents/2024/WorkGroups/House%20Appropriations/Bills/S.56/Drafts,%20Amendments,%20and%20Legal%20Documents/S.56~Katie%20McLinn~House%20Ways%20and%20Means%20Committee%20Report%20(9-3-0)~5-9-2023.pdf

[2] https://legislature.vermont.gov/Documents/2024/Docs/BILLS/H-0494/H-0494%20As%20Passed%20by%20the%20House%20Unofficial.pdf

for children on a full-day basis on or before July 1, 2026. The 18-member committee would have the administrative, technical, fiscal, and legal assistance of both Agency of Education (AOE) and the Agency of Human Services (AHS). If the agencies are unable to provide the committee with adequate support, AOE would retain a contractor with the necessary expertise to assist the committee. The committee would cease to exist on February 1, 2025.

This section of the bill would appropriate the following amounts from the General Fund to AOE in fiscal year 2024:

- $7,500 for per diem compensation and reimbursement of expenses for eligible committee members.
- $100,000 for the cost of retaining a contractor.

Any funds not spent or obligated by July 1, 2025, would revert to the General Fund.

Pupil Weighting

Section 3 – Determination of Weighted Long-Term Membership and Per Pupil Education Spending

Sec. 3 would change the pupil weight for prekindergartners from -0.54 to 0.[3] Adjusting pupil weights impacts the tax capacity of school districts. By changing the weight, all else equal, some districts' tax rates would increase, while other districts' tax rates would decrease. A change in weights affects a district's per pupil spending calculation, which in turn affects the district's tax rate. In other words, assuming all education spending remains constant, some districts would have higher homestead property tax rates (those that have fewer pupils with the new weight than they had from the prior weight); and some districts would have lower homestead property tax rates (those that have more pupils with the new weight). Because local votes ultimately determine education spending, changing the prekindergarten pupil weight would directly impact the tax capacity of most school districts but would not determine the amount of funding a school district receives.

Section 3a – Contingent Effective Date of Prekindergarten Education Weight Change

Sec. 3a creates a contingency for the change to the prekindergarten pupil weight. The pupil weight shall not be changed unless the General Assembly enacts legislation that establishes: the minimum number of hours for full-day prekindergarten; a requirement that all school districts follow the minimum number of hours; and a requirement that school districts follow the same contracting requirements for the provision of prekindergarten education

Child Care Financial Assistance Program

Sections 5a, 5b, and 5c – Child Care Financial Assistance Program (CCFAP) Eligibility

Sec. 5a would expand CCFAP – a State program that currently provides financial assistance for child care based on a family's income. The bill as amended would increase the number of families eligible for a $0 co-payment. Effective April 1, 2024, eligibility would expand from those with an annual gross income less than or equal to 150% FPL to those with an annual gross income less than or equal to 175% FPL. It would also expand the income eligibility for CCFAP subsidies from 350% to 400% FPL, also effective April 1, 2024. Sec. 7 contains the appropriation to cover the estimated fiscal impact of this section.

2023 ANNUAL Federal Poverty Levels (FPLs)

Household Size	150%	175%	350%	575%
3	$37,290	$43,505	$87,010	$142,945
4	$45,000	$52,500	$105,000	$172,500
5	$52,710	$61,495	$122,990	$202,055

https://aspe.hhs.gov/poverty-guidelines

[3] Pupil weights are used in Vermont's education finance formula to adjust student counts to account for the variation in costs incurred by schools serving different student needs or circumstances.

Sec. 5b would allow Vermont residents who have citizenship status that would otherwise exclude their families from participating in CCFAP to be served by the program, provided that the benefit is solely State-funded. Sec. 7 contains the appropriation to cover the estimated fiscal impact of this section. While there is very limited data from which to estimate the fiscal impact of this section, JFO believes that this expansion is subsumed in its estimates, which took into consideration the entire population of Vermont children, not just those with the currently required citizenship status.

Sec. 5c would further expand eligibility for subsidies from 400% FPL to 575% FPL on October 1, 2024 (in fiscal year 2025).

Section 5d – Family Contribution

Sec. 5d would increase the family contribution for families at 176% FPL from the current $50 per week to $52 per week and increase progressively, as determined by DCF, for families at higher income levels, effective April 1, 2024. JFO modeled the family contributions as multiples of $26 per week, illustrated in the table below. Sec. 7 contains the appropriation to cover the estimated fiscal impact of this section.

Federal Poverty Level (FPL) and Associated Weekly Family Contribution									
Family Share (FPL)	</=150%	>150% to 175%	>175% to 200%	>200% to 225%	>225% to 250%	>250% to 275%	>275% to 300%	>300% to 325%	>325% to 350%
Current	$0	$25	$50	$75	$100	$125	$150	$175	$200
Proposed	$0	$0	$52	$78	$104	$130	$156	$182	$208

⇨ Up to 575% FPL

Section 6 – Provider Rate Adjustment

Sec. 6 would increase the rates paid to providers for children enrolled in CCFAP to levels that are 35% over the fiscal year 2023 five-STAR (highest quality) reimbursement rate, effective January 1, 2024.[4] These rate increases would become part of the DCF base budget in future fiscal years. Sec. 7 contains the appropriation to cover the estimated fiscal impact of this section.

Section 7 – Appropriation

Sec. 7 would appropriate the following amounts from the General Fund to DCF's Child Development Division (CDD) in fiscal year 2024:

- $47.3 million for the CCFAP expansion and rate adjustments in Secs. 5 through 6. Of those funds, the estimated fiscal year 2024 fiscal impact for:
    - Increasing reimbursement rates to the five-STAR level is approximately $4.8 million.
    - Further increasing rates by 35% higher than the fiscal year 2023 five-STAR[5] rate is approximately $38.3 million.[6]
    - Expanding eligibility for $0 co-pays from 150% FPL to 175% FPL, increasing CCFAP eligibility from 350% FPL to 400% FPL, and increasing the incremental co-pays families at 176% FPL and higher would pay, is approximately $4.2 million.
- $4 million to administer the CCFAP expansion and rate adjustment in Secs. 5 through 6 including:
    - The creation of 11 new permanent classified positions within CDD.
    - At least $2 million to be allocated to the Community Child Care Support Agencies (CCCSAs).
    - $266,707 allocated to Building Bright Futures in Sec. 20.

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[4]JFO estimates that a 38.5% rate increase is that amount needed to get half-way to the estimated total costs of care based on the 2022 Vermont Early Care and Education Financing Study conducted by the RAND Corporation.

[5]STARS (Step Ahead Recognition System) is Vermont's Quality Recognition and Improvement System for child care, preschool, and afterschool programs. STARS is currently one of several factors the State uses in determining the rate paid to a provider.

[6] This estimate includes rate increases for providers of both children 0-4 and school aged children.

Section 8 – Readiness Payments
Sec. 8 would appropriate $20 million in one-time funds from the General Fund to CDD in fiscal year 2024 for readiness payments to providers to prepare for the CCFAP eligibility expansion and provider rate adjustments in Secs. 5 through 6. Up to 5% of the appropriation could be used to contract with a third party to provide technical assistance to child care providers.

Sections 9 and 9a – Payments to Providers
Sec. 9 would require that DCF establish a payment schedule that would increase provider reimbursements over the previous year's rate annually in alignment with the most recent annual average wage growth for NAICS code 611 (Educational Services) but not to exceed 5 percent.[7] Beginning January 1, 2024, payments would be based on enrollment (not attendance).

Sections 10 and 10a – Child Care Quality and Capacity Incentive Program
Sec. 10 would require DCF establish a new child care quality and capacity incentive program for providers participating in CCFAP. Providers would receive incentive payments for achievements that meet criteria as specified in the bill. The incentive payment program would begin on July 1, 2024. While the amount of the payments to be distributed to providers would be subject to future appropriations, the bill includes intent language in Sec. 10a that the appropriation for the program be at least $10 million in fiscal year 2025 and in future fiscal years.

Transitional Assistance and Governance

Sections 19 and 20 – Building Bright Futures
Sec. 19 would require that Building Bright Futures (BBF) be responsible for monitoring accountability, supporting stakeholders in collectively defining and measuring success, maximizing stakeholder engagement, and providing technical assistance to build capacity for CDD and AOE.

Sec. 20 would allocate $266,707 to BBF from the $4 million appropriated to DCF in Sec. 7. This allocation would become part of DCF's base budget.

Personal Income Tax Rates

Sections 24, 25, 27 and 28 – Personal Income Tax Rates and Earned Income Tax Credit
The bill makes several changes in the personal income tax code that increase personal income tax revenue. It expands the Earned Income Tax Credit (EITC) amounts in tax year 2024 and makes technical changes to both the EITC and the Child Tax Credit (CTC).

The first change increases the tax rate in each income tax bracket for tax year 2024. Rates would increase progressively, with the lower brackets seeing relatively smaller increases and the higher brackets seeing relatively larger increases. The first bracket would increase by 0.3%, the second and third brackets would increase by 0.7%, and the top marginal bracket would increase by 0.85%.

Brackets	Current Marginal Rate	Proposed New Marginal Rate	Tax Rate Increase	Percent Increase
1	3.35%	3.65%	+0.30%	+9%
2	6.60%	7.30%	+0.70%	+11%
3	7.60%	8.30%	+0.70%	+9%
4	8.75%	9.60%	+0.85%	+10%

JFO estimates that these increases in personal income tax rates would generate approximately

[7] https://www.naics.com/naics-code-description/?code=611

$125.4 million in additional revenue to the General Fund in fiscal year 2025. [8]

Earned Income Tax Credit Expansion
The second change the bill would make to the personal income tax code would be to expand the EITC. Vermont taxpayers who are eligible for the federal EITC can currently claim the Vermont EITC, which is equal to 38% of their federal credit claimed.

Claimants with one or more qualifying dependent children would become entitled to receive 55% of their federal credit. Claimants with no qualifying dependent children would be eligible to receive 100% of the federal credit. The Vermont EITC is fully refundable – if the credit amount is greater than the claimant's State tax liability, they would receive the difference in the form of a check from the State.

JFO estimates that this expansion of the EITC would reduce personal income tax revenue to the General Fund by approximately $14.4 million in fiscal year 2025. The net of increasing personal income tax rates and expanding the EITC is estimated to increase revenue generated by approximately $111.0 million[9] in fiscal year 2025.

The bill would make those without a social security number (SSN) eligible for the EITC and the CTC eligible to receive those credits. Currently, Vermonters are required to have an SSN to claim either credit. This change would allow those with an Individual Taxpayer Identification Number (ITIN) or those without any form of tax identification number to claim the EITC and CTC if otherwise eligible. The bill would charge the Vermont Department of Taxes to adopt rules and processes to verify income and other information in order to determine whether these claimants are in fact eligible. These technical changes would be effective in tax year 2023.

JFO estimates that neither of these changes would have a significant impact on State revenues, since this population of taxpayers is very small.

Supplemental Personal Income Tax Increase
The last change to the personal income tax code would be an additional increase in personal income tax rates effective for tax year 2027, which would affect tax revenues starting in fiscal year 2028. This supplemental increase is proposed in anticipation of increased CCFAP reimbursements as the child care system moves towards 100% implementation. This tax rate increase would also be progressive. The lowest bracket's tax rate would increase by 0.15%, the second bracket would increase 0.2%, the third bracket would increase 0.25% and the top marginal bracket would increase by 0.45%.

Brackets	Current Marginal Rate	Proposed New Marginal Rate	Tax Rate Increase
1	3.65%	3.80%	0.15%
2	7.30%	7.50%	0.20%
3	8.30%	8.55%	0.25%
4	9.60%	10.05%	0.45%

JFO estimates that this supplemental tax rate increase will generate approximately $57.5 million in additional revenue to the General Fund starting in fiscal year 2028. [10]

[8] This figure has been adjusted for forecasted inflation to represent 2025 dollars.
[9] These figures have been adjusted for forecasted inflation to represent 2025 dollars.
[10] This figure has been adjusted for forecasted inflation to represent 2028 dollars.

Corporate Income Tax Rates

Section 26 – Corporate Income Tax Rates

The bill would progressively increase corporate income tax rates for tax year 2024. The first bracket would increase 0.5%, the second bracket would increase 1.0% and the top marginal bracket would increase by 1.5%.

Income Allocable to Vermont	Existing Tax Rate	Proposed New Marginal Rate	Tax Rate Increase
$0 to$10,000	6.0%	6.5%	+0.5%
$10,000 to$25,000	7.0%	8.0%	+1.0%
$25,000 and up	8.5%	10.0%	+1.5%

This change would affect the roughly 10,000 corporations that report positive net income in the average year. **JFO estimates that these changes will generate approximately $20.6 million[11] in additional revenue to the General Fund in fiscal year 2025.**

SALT Deduction Cap Workaround

Sections 32 through 34 – State and Local Taxes (SALT)

Sections 32 through 34 would create a new elective, entity-level tax on certain pass-through businesses, including partnerships and S-Corporations. The pass-through entity (PTE) tax rate would be set equal to the second highest marginal tax rate in 32 V.S.A. §5822, which in tax year 2023 would be equal to 7.6%. In the bill, the second highest marginal rate would increase to 8.3% in tax year 2024. The PTE tax rate would increase to this rate as well in tax year 2024.

The bill also creates a State personal income tax credit equal to 87.5% of the PTE tax paid by an individual. Taxpayers could receive an 87.5% credit for PTE tax paid to other states, as well. All members and officers of a pass-through entity would have to elect to be liable for the PTE tax and renew their election annually. The bill includes language that would repeal the PTE tax if federal limitations on the SALT deduction are repealed.

This tax structure is often called a "SALT Cap Workaround" because the pass-through business member's share of entity-level tax paid would be considered a business expense for federal individual tax purposes. The amount of PTE tax that could be deducted from federal taxes would not be limited by the $10,000 State and Local Taxes (SALT) deduction cap implemented by the federal Tax Cuts and Jobs Act of 2017 (TCJA). Overall, this structure could significantly reduce a pass-through owner's federal taxable income and tax liability. JFO estimates that the PTE tax would reduce federal tax liabilities for members of a pass-through entity that pays the tax by approximately $10 to $20 million annually.

	Tax Year 2023	Tax Year 2024	Tax Year 2025
PTE Tax Rate	**7.6%**	**8.3%**	**8.3%**
PTE Personal Income Tax Credit	**87.5%**	**87.5%**	**87.5%**

JFO estimates this change would increase General Fund revenues by approximately $1.7 million annually in fiscal years 2024 through 2026. TCJA provisions that limit the size of the SALT deduction are currently set to sunset at the end of tax year 2025, limiting State revenue generation to those three fiscal years.

This estimate depends on the number of pass-through businesses that elect to pay the new PTE tax. While

[11] This figure has been adjusted for forecasted inflation to represent 2025 dollars.

taxpayers with large amounts of pass-through income would generally save money on their federal taxes if they elect the PTE tax, it may not be advantageous for all pass-through businesses. If fewer taxpayers elect to take the PTE tax due to the specifics of their tax situation or the structure of the PTE tax and corresponding credit, the revenue received by the State will decrease accordingly.

There will be some administrative costs associated with setting up the new tax, but the Department of Taxes does not predict a need for additional staff.

Fiscal Summary

The following chart highlights the appropriations and revenues in the bill as amended by the House Committee on Ways & Means.

S.56 Summary of Appropriations and Funding

Sec.	Appropriation	FY 2024 (x million)	Est. FY2025	Effective
2	Pre-K Implementatation Comm - Per Diems	$0.0075		7/1/2023
	Pre-K Implementatation Comm - AOE Contractor	$0.1		
5-7, 9	CCFAP Eligibility Expansion and Rate Increase	$47.3	$116.3	Sec. 7 - 7/1/2023
	- 0-4 Rate & Eligibility Expansion = $43.5 million			Secs. 5, 6, & 9 - 1/1/2024
	- School Age Rate & Eligibility Exp. = $3.8 million			Sec. 5a & 5d - 4/1/2024
	DCF Admin. of CCFAP Expansion	$4.0	$4.2	Sec. 5b - 7/1/2024
	- CCCSA's = At least $2 million			Sec. 5c - 10/1/2024
20	- Building Bright Futures = $266,067			7/1/2023
8	Readiness Payments (one-time)	$20.0	-	7/1/2023
10	Quality & Capacity Incentives	-	$10.0	7/1/2024
Total Estimated Appropriation		**$71.4**	**$130.5**	
House Passed H.494 (Big Bill) Funding				
	FY24 One-time funding	**($21.7)**		
	FY24 Base General Funds	**($50.0)**	**($50.0)**	
REVENUES		(x million)		
24, 25	Personal Income Tax		$125.4	Sec. 24 - 1/1/2024
				Sec. 25 - 1/1/2027
26	Corporate Income Taxes		$20.6	1/1/2024
27	Earned Income Tax Credit		($14.4)	1/1/2024
32, 33	SALT Deduction Cap Workaround	$1.7	$1.7	7/1/2023
Total New Revenues		**$1.7**	**$133.3**	
REVENUES - EXPENSES		**$2.0**	**$52.8**	