

ANALYSIS OF AMENDED BILL

Franchise Tax Board

Author: Daucher Analyst: LuAnna Hass Bill Number: AB 1383

Related Bills: See Legislative History Telephone: 845-7478 Amended Date: April 16, 2001

Attorney: Patrick Kusiak Sponsor: _____

SUBJECT: Personal Exemption Credit For Dependents May Be Divided Equally Between The Parents

SUMMARY

This bill would allow parents to divide the dependent exemption credit equally.

SUMMARY OF AMENDMENTS

The April 16, 2001, amendments would:

- require parents to have a notarized, written agreement that is signed by both parents in order to divide the dependent exemption credit,
- require parents to divide the dependent exemption credit equally,
- eliminate language that would have allowed parents to divide the credit in any proportion,
- define "dependent child" for purposes of this provision, and
- specify that taxpayers dividing the dependent exemption credit may not claim the joint custody head of household credit.

This is the department's first analysis of this bill.

PURPOSE OF THE BILL

The author's staff has indicated that the bill's purpose is to allow parents who split the costs associated with rearing the same child to likewise split the dependent exemption credit.

EFFECTIVE/OPERATIVE DATE

As a tax levy, this bill would be effective upon enactment and operative for taxable years beginning on or after January 1, 2001.

POSITION

Pending.

ANALYSIS

FEDERAL/STATE LAWS

Existing federal and state laws provide various tax incentives to taxpayers with dependents.

Board Position:	Department Director	Date
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_____ X PENDING	Alan Hunter for GHG	05/11/2001

Federal law allows a child tax credit of \$500 for each dependent child under the age of 17, subject to phase out limitations.

Federal law also provides various personal and dependent exemptions that are subject to income limitations. A parent that has custody of a child for the greater part of a calendar year is the "custodial parent" and would generally be entitled to the personal exemption for the dependent child. If the custodial parent signs a written declaration that he or she will not claim the exemption for any taxable year, the noncustodial parent is entitled to the exemption. These exemptions are treated as deductions from adjusted gross income (AGI). The exemption deduction amount is indexed annually for inflation and is \$2,800 for the 2000 tax year. Exemption deductions begin to phase out at federal AGI levels over specified amounts, which are the same amounts as those for state law noted below.

State law provides various exemption credits, including a personal exemption and exemptions for dependents, blind persons, and individuals 65 or older. Unlike federal law, these exemptions are not deductions from AGI but are credits against tax. The amount of exemption credits for the 2000 tax year is \$235 for the dependent credit and \$75 for all other exemption credits. The exemption credit amounts are indexed annually for inflation. The total number of exemptions claimed is multiplied by the exemption credit amount to obtain the total exemption credit. The exemption credits are not refundable and may not be carried over to future years.

Exemption credits begin to phase out at federal AGI levels over the amounts listed below:

<u>Filing Status</u>	<u>AGI (2000)</u>
Single/Married Filing Separate	\$124,246
Head of Household	\$186,370
Married Filing Joint/Qualifying widow(er)	\$248,494

Current state law also allows a joint custody head of household credit equal to 30% of the individual's tax liability (not to exceed \$299 for 2000) to an individual who meets certain requirements.

Availability of a dependent exemption for federal purposes determines a taxpayer's eligibility for other tax provisions such as the head of household filing status for federal and state tax purposes, the federal dependent child care credit, and the state refundable child care credit.

THIS BILL

This bill would allow parents to divide the dependent exemption credit equally. The credit would be allowed regardless of marital status, filing status, or support provided by the parents. This bill would require parents to have a notarized, written agreement that is signed by both parents in order to divide the dependent exemption credit.

This bill would define "dependent child" for purposes of this bill.

This bill also would specify that taxpayers dividing the dependent exemption credit may not claim the joint custody head of household credit.

IMPLEMENTATION CONSIDERATIONS

This bill uses a term that is undefined, i.e., "parent." Therefore, it is unclear who qualifies for this credit. The author's office has indicated that it is the intent to include parents that are single, divorced, or remarried. A definition for this term would be helpful to ensure that disputes do not arise.

The definition of dependent child that is provided in this bill would repeat the existing statutory definition of child, except that the existing support requirement has been eliminated. As a result, this bill could be interpreted to allow the parent of an individual to split the credit with the taxpayer that currently claims the credit for that individual regardless of the support provided by either the taxpayer or the parent.

The bill allows parents to divide the state dependent exemption credit of a child. However, it does not make that child the dependent of either parent for other state tax purposes such as the dependent care credit or head of household filing status.

TECHNICAL CONSIDERATIONS

This bill erroneously identifies the dependent exemption credit as the credit under section 17054. Section 17054 consists of subdivisions that also outline the personal exemption and additional exemption credits for taxpayers that are blind or over 65 years of age. Consequently, this bill could be interpreted to allow the parents of any individual taxpayer to claim any of the above exemption credits that are allowed to that individual taxpayer. A technical amendment should be made to limit the credit to the credit allowed under this "subdivision" rather than this "section."

LEGISLATIVE HISTORY

AB 53 (Pacheco, 1999/00) as introduced December 7, 1998, would have allowed both custodial and noncustodial parents to claim a personal exemption credit for the same child under certain conditions. This bill failed to pass out of the first house by January 31 of the second year of the session.

OTHER STATES' INFORMATION

These states have the following dependent exemption amounts, although the tax law for each state does not address the issue of splitting the exemption between parents.

- *New York* has a dependent only exemption of \$1,000 per dependent.
- *Illinois* has a dependent exemption of \$1,650 per federal exemption.
- *Massachusetts* has a dependent exemption of \$1,000 per dependent.
- *Michigan* has a dependent exemption of \$2,900 per federal exemption.
- *Minnesota* has a dependent exemption of \$2,800 per federal exemption.

These states were reviewed because of the similarities between California income tax law and those states' income tax law.

FISCAL IMPACT

This bill would not significantly impact the department's costs.

ECONOMIC IMPACT

Revenue Estimate

Based on the data and assumptions below, revenue losses are estimated as follows:

Estimated Revenue Impact			
Taxable Years Beginning On or After January 1, 2001			
Enactment Assumed After June 30, 2001			
Fiscal Years			
(In Millions)			
	2001-2	2002-3	2003-4
Dependent Credit Split	-\$7.9	-\$8.3	-\$8.7

This analysis does not consider the possible changes in employment, personal income, or gross state product that could result from this measure.

Revenue Discussion

The impact of this bill would depend on the number of nontaxable parents relinquishing 50 percent of a dependent credit to the other parent. It is assumed that the relinquishing parent would remain nontaxable after transfer of 50 percent of the dependent credit. The transfer of 50 percent of a dependent credit between parents who both have tax liabilities to offset would not generate a revenue loss under this proposal.

This revenue estimate is based on the department's latest personal income tax model. Approximately 325,000 nontaxable filers would remain nontaxable if they were to give-up 50 percent of one dependent credit. It is assumed that nontaxable filers who could presently transfer an entire dependent credit to the other parent under current law, and remain nontaxable, would not take advantage of the transfer allowed under this proposal and were excluded from the identified universe. Based on information from the U.S. Statistical Abstract and in-house sources, it is assumed that 20 percent of the identified nontaxable filers would transfer 50 percent of a dependent credit, or \$122, to the other parent and that the other parent would be able to offset their tax liability with the credit.

ARGUMENTS/POLICY CONCERNS

Existing state tax law provides a joint custody head of household credit to benefit a noncustodial parent who supports a child. Depending on the circumstances, the parent may be able to claim both the joint custody head of household credit and the personal exemption credit allowed under this bill.

Federal and state tax laws have never allowed the tax benefits associated with a single dependent to be available to more than one taxpayer. Consequently, the sharing of the dependent exemption credit proposed by this bill is unprecedented.

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