Franchise Tax Board

ANALYSIS OF ORIGINAL BILL

Author:	La Suer	Analyst:	LuAnna Hass	Bill Number:	AB 847
Related Bills:	See Legislative History	Telephone:	845-7478	Introduced Date:	February 22, 2001
		Attorney:	Patrick Kusiak	Sponsor:	

SUBJECT: Household And Dependent Care Services Necessary For Gainful Employment Refundable Credit/Increase Percentage/Add Repeal Date

SUMMARY

This bill would make the following changes to the Household and Dependent Care Credit:

- increase the income amount used to determine the credit percentage claimed by the taxpayer,
- increase the credit percentages,
- eliminate the refundable provision, and
- add a sunset date.

PURPOSE OF THE BILL

It appears that the author's intent is to increase the credit percentage to allow taxpayers a greater tax benefit than is allowed under current law.

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, and before January 1, 2008.

POSITION

Pending.

ANALYSIS

FEDERAL/STATE LAW

Existing federal law allows a tax credit of 20-30% (depending on the taxpayer's adjusted gross income (AGI)) of employment-related costs of care for a qualifying individual. A qualifying individual is defined as a dependent of the taxpayer that is under the age of 13 or a dependent or spouse who is physically or mentally unable to care for themselves. Employment-related expenses are generally defined as those expenses incurred to enable gainful employment. These expenses are limited to the lesser of the taxpayer's earned income or $2,400 per taxable year for one qualifying individual, or $4,800 if there are two or more qualifying individuals.

Board Position:			Department Director	Date
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Starting in the year 2000, AB 480 (Ducheny, Ch.114, Stats. 2000) enacted a refundable credit based on a percentage of the taxpayer's federal household and dependent care credit, as defined above. The percentages are:

State AGI:	Credit Percentage:
$40,000 or less	63%
Over $40,000 but not over $70,000	53%
Over $70,000 but not over $100,000	42%
Over $100,000	0%

Currently, this provision does not contain a sunset date.

THIS BILL

This bill would increase the state AGI amounts used to determine the percentage of the federal credit claimed by the taxpayer, as well as the credit percentages, as shown below:

State AGI:	Credit Percentage:
Not over $70,000	100%
Over $70,000 but not over $100,000	84%
Over $100,000	0%

This bill would remove the language that allows the credit to be refundable and would replace it with language allowing the credit to be carried over to succeeding years until exhausted. This bill would limit the availability of the credit to taxable years beginning before January 1, 2008, and also would add a repeal date of December 1, 2008.

IMPLEMENTATION CONSIDERATIONS

The department had not administered a refundable tax credit under the Personal Income Tax Law (PITL) since the refundable renter's credit was suspended in 1993. Establishing a refundable tax credit program has had a significant impact on the department's programs and operations and required extensive changes to forms and systems. Removing the refundable provision would simplify the processing of returns, as non-refundable returns are less likely to be fraudulently filed and require less scrutiny. The changes to the income levels, credit percentages, and sunset date would not significantly impact the department's programs and operations. All changes could be accomplished during the normal annual update.

This bill adds language allowing the credit to be carried over but does not limit the number of years. Recent credits have been enacted with a carryover limit since experience shows credits are typically used within eight years of being earned.

LEGISLATIVE HISTORY

AB 480 (Ducheny, Ch. 114, Stats. 2000) created the credit being amended by this bill. AB 149 (Leach, 1999) and AB 1728 (Floyd, 1998) would have allowed taxpayers a credit similar to AB 480. AB 149 failed to pass out of the first house by January 31 of the second year of the session, and AB 1728 failed passage in the Assembly Appropriations Committee.

OTHER STATES' INFORMATION

Review of Florida, Illinois, Massachusetts, Michigan, Minnesota, and New York laws resulted in comparable tax credits or deductions for certain household and dependent care services that are necessary for gainful employment, and are listed below. These states were reviewed because of the similarities between California income tax laws and their tax laws.

Massachusetts allows taxpayers a deduction for tax years beginning on or after January 1, 2001, that is limited to $3,600 a taxable year for one qualifying individual or $7,200 if there are two or more qualifying individuals. The deduction amounts increase to $4,800 and $9,600, respectively, for taxable years beginning on or after January 1, 2002.

New York allows taxpayers a refundable credit based on a percentage of the federal child care credit adjusted by New York income levels. The credit is at least 100% for taxpayers with incomes up to $50,000. For incomes over $50,000 the credit is reduced incrementally to the minimum of 20% for taxpayers with incomes over $65,000.

FISCAL IMPACT

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

ECONOMIC IMPACT

<u>Tax Revenue Estimate</u>

The net gain in revenue on balance under the Personal Income Tax Law is estimated to be:

Fiscal Year Cash Flow Taxable Years Beginning After December 31, 2000 Estimates Assume Enactment after June 30, 2001 $ Millions		
2001-02	2002-03	2003-04
$24	$23	$21

It is assumed that this credit would not allow a taxpayer to reduce tax liability below tentative minimum tax.

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

<u>Revenue Discussion</u>

The revenue impact under the Personal Income Tax Law would depend on the number of taxpayers with adjusted gross incomes below $100,000 who are eligible for the Federal household and dependent care credit and the amount of the credit that could be used to offset tax liability compared with the amount of refundable credit that those taxpayers would have received under current law.

The above estimates were based on simulations using the department's personal income tax model. Special programming was done to reflect the federal law, the percentages of federal credits, and phase-out effects.

ARGUMENTS/POLICY CONCERNS

Historically, refundable credits have had significant problems with fraud. These problems are aggravated because once a refund that is made is later determined to be fraudulent, the refund commonly cannot be recovered. Striking the refundability provision from this credit would substantially reduce the department's concerns about fraud.

This bill provides taxpayers with an AGI of $70,000 or less a state credit in an amount equal to the federal credit. In general, a taxpayer's federal income tax liability is higher than his or her state income tax liability. As a result, a state tax credit equal to a federal credit could be considered to provide a greater proportionate benefit for state tax purposes than for federal tax purposes.

LEGISLATIVE STAFF CONTACT

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