

SUMMARY ANALYSIS OF AMENDED BILL

Author: Jones Analyst: Nicole Kwon Bill Number: AB 21
 Related Bills: See Prior Analysis Telephone: 845-7800 Amended Date: May 9 & 15, 2007
 Attorney: Patrick Kusiak Sponsor: _____

SUBJECT: Earned Income Refundable Credit

- DEPARTMENT AMENDMENTS ACCEPTED. Amendments reflect suggestions of previous analysis of bill as introduced December 4, 2006.
- AMENDMENTS IMPACT REVENUE. A new revenue estimate is provided.
- _____ AMENDMENTS DID NOT RESOLVE THE DEPARTMENT'S CONCERNS stated in the previous analysis of bill as introduced/amended _____.
- _____ FURTHER AMENDMENTS NECESSARY.
- _____ DEPARTMENT POSITION CHANGED TO _____.
- REMAINDER OF PREVIOUS ANALYSIS OF BILL AS INTRODUCED December 4, 2006, STILL APPLIES.
- _____ OTHER – See comments below.

SUMMARY

This bill would allow a refundable Earned Income Credit (EIC) equal to 15% of the federal EIC.

SUMMARY OF AMENDMENTS

The May 9, 2007, amendments would do the following:

- Add a co-author to the bill.
- Add an urgency clause that would make the provisions of the bill effective immediately upon enactment, but expressly operative for taxable years beginning on or after January 1, 2007.
- Remove the provision specifying that the proposed EIC would be refunded to the taxpayer only if funds are appropriated for that purpose by the Legislature.
- Remove the provision relating to advance payment of EIC.
- Make necessary technical changes to refer to the current applicable federal laws.

The May 15, 2007, amendments would allow part-year residents of California to receive the EIC based on their California adjusted gross income.

Board Position:	Legislative Director	Date
_____ S		
_____ SA	Patrice Gau-Johnson	5/18/07
_____ N	For Brian Putler	
_____ NA		
_____ O		
_____ OUA		
_____ NP		
_____ NAR		
<input checked="" type="checkbox"/> PENDING		

With these amendments, the Technical Considerations identified in the department's prior analysis are resolved; some of the Implementation Considerations and the Policy Concern still remain unresolved and are included below. In addition, as a result of the amendments, a revised revenue estimate is included below. The remainder of the department's analysis of the bill as introduced December 4, 2006, still applies.

IMPLEMENTATION CONSIDERATIONS

Many taxpayers eligible for the federal EIC have no California income tax return filing requirement. Some 650,000 (married filing joint is counted as one return) current taxpayers who have no filing requirement would be required to file a California income tax return to claim the proposed EIC, which would significantly impact the department's programs and costs.

Generally, low-income taxpayers would claim the credit proposed under this bill. Low-income taxpayers generally file their tax returns on Forms 540A or 540-2EZ. To add the EIC to the California income tax forms, several lines would be added each to Forms 540, 540A, 540NR, and the scannable Form 540. If there is a need to attach another page to the Form 540-2EZ, the taxpayers currently filing on the Form 540-2EZ would be required to file a Form 540 or a Form 540A to claim the proposed EIC. Changes to these tax forms would result in a significant impact on the department's operations and costs.

Typically, refund returns are filed early in the filing season. If taxpayers claiming the California EIC file late in the filing season, after they receive their federal EIC, then that behavior could have a major impact on the processing of returns and possibly cause delays in the issuance of refunds. The taxpayer error rate on the federal EIC and fraud concerns causes the IRS to adjust many returns. Consequently, the correct federal EIC amount may not be known until after the taxpayer has filed the state return, claimed the proposed California credit, and received their refund. The Franchise Tax Board could be required to issue an assessment to retrieve incorrect refunds and incur costs to do so.

POSITION

Pending.

ECONOMIC IMPACT

Revenue Estimate

Estimated Revenue Impact of AB 21 Effective On Or After January 1, 2007 Enactment Assumed After June 30, 2007 (\$ in Millions)			
	2007-08	2008-09	2009-10
Reduced Liabilities	-\$14	-\$14	-\$14
Refunds	-\$686	-\$696	-\$706
Total	-\$700	-\$710	-\$720

This estimate does not account for changes in employment, personal income, or gross state product that could result from this bill.

Revenue Discussion

The revenue impact of this credit would depend on the number of California taxpayers claiming the federal EIC. This amount, in turn, depends on the amount of earned income and adjusted gross income claimed by low-income Californians and whether they currently file a tax return. It is assumed that almost all taxpayers who avail themselves of the federal credit will also avail themselves of the state credit. There is a significant number of taxpayers who are eligible for but do not avail themselves of the federal EIC. It is assumed that the availability of a California EIC would not entice a significant number of taxpayers who already fail to claim the federal EIC to begin claiming the California EIC.

The starting point for this estimate is the amount of federal EIC received by taxpayers with a California address in the 2004 tax year, which is approximately \$4.5 billion. This number is then adjusted from the 2004 level to the 2011 level by overall return growth projections.

The amount of the federal EIC for 2008 is estimated to be \$4.7 billion. For each tax year, the estimated federal EIC amount is multiplied by 15%, the proposed state credit rate, to arrive at the total state impact for that year. The estimated revenue impact for 2007 is \$700 million (\$4.7 billion x 15%). IRS statistics show that 15% of federal EIC claimed by taxpayers with a California address is used to offset federal tax liabilities. Because filing thresholds are higher for California taxes than for federal taxes, this estimate assumes that only 2% of California EIC would be used to offset California tax liabilities, the rest would generate refunds.

POLICY CONCERN

The IRS has experienced a significant number of invalid and fraudulent returns in connection with the refundable federal EIC. According to a study conducted by the IRS entitled "Compliance Estimates for the Earned Income Credit Claimed on 1999 Returns," of the \$31.3 billion claimed in federal EIC, it is estimated that between \$8.5 and \$9.9 billion were invalid or fraudulent claims.

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