Franchise Tax Board

SUMMARY ANALYSIS OF AMENDED BILL

Author:	Dickinson	Analyst:	Brian Werking	Bill Number:	AB 1974
Related Bills:	See Prior Analysis	Telephone:	845-5103	Amended Date:	May 16, 2012
		Attorney:	Patrick Kusiak	Sponsor:	

SUBJECT: Earned Income Tax Credit

SUMMARY

The bill would create an earned income tax credit (EITC) in an amount equal to 15 percent of the federal EITC.

RECOMMENDATION

No position.

SUMMARY OF AMENDMENTS

The May 16, 2012, amendments further specify that the EITC is only available to individual California resident taxpayers that are eligible for the federal earned income tax credit, as in effect January 1, 2012. The amendments would exempt the Franchise Tax Board (FTB) from the rulemaking procedures required under the Administrative Procedures Act (APA)[1] when implementing this bill and would provide that FTB determinations regarding the waitlist would not be reviewable in an administrative or judicial proceeding.

As a result of the amendments, two of the department's "Implementation Considerations" have been resolved, while the remainder still exist. The "This Bill," and "Implementation Considerations" sections of the department's analysis of this bill as amended March 26, 2012, have been revised. The remainder of that analysis still applies. The "Fiscal Impact," "Economic Impact," "Legal Impact," and "Policy Concerns" sections have been restated for convenience.

[1] Government Code section 11340 et seq.

Board Position:			Legislative Director	Date
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ANALYSIS

THIS BILL

This bill would provide a state EITC equal to 15 percent of the federal EITC as in effect on January 1, 2012. Any state credit in excess of the state tax liability would be credited against other amounts due, and the balance would be refunded to the taxpayer, if an appropriation was made by the Legislature. Any refund would be excluded from taxable income and would not be considered income for purposes of determining amounts or eligibility for other benefits[2]. The refunded portion of the state EITC would be provided for by an appropriation from the Legislature to the Tax Relief and Refund Account.

The bill would provide that when the appropriation is insufficient to cover the total amount of the EITC refunds due taxpayers for any taxable year, the FTB would establish and maintain a list of taxpayers that are owed a refund. The FTB would establish an order of priority within the waitlist, based on the date the FTB receives a taxpayer's return. The date a taxpayer's return is received, as determined by the FTB for purposes of establishing the waitlist, would not be reviewable in any administrative or judicial proceeding. The FTB would also be required to notify each taxpayer that has been placed on the waitlist.

The bill would provide that in any year for which no appropriation has been made by the Legislature, the EITC could be carried over to succeeding taxable years until the amount of the credit is exhausted.

This bill defines the following:

- "Federal earned income credit amount" means the amount determined under Section 32 of the Internal Revenue Code, as in effect on January 1, 2012, with respect to the qualified taxpayer for federal income tax purposes for the taxable year in which the credit allowed under this section is claimed.

- "Qualified taxpayer" means an individual who is a resident of California who is eligible for a credit, for federal tax purposes, under Section 32 of the Internal Revenue Code, relating to earned income, as in effect on January 1, 2012, for the taxable year in which the credit is allowed under this section.

This bill specifies that no credit shall be allowed to (1) any person who is a nonresident for any portion of the taxable year, or (2) any person who is married and files a separate return for the taxable year.

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[2] Benefits provided under Division 9 (commencing with Section 10000) of the Welfare and Institutions Code.

For purposes of implementing, interpreting, or making specific the provisions related to the state EITC, the FTB would be specifically exempt from the rulemaking procedures required under the APA.[3]

IMPLEMENTATION CONSIDERATIONS

The department has identified the following implementation concerns. Department staff is available to work with the author's office to resolve these and other concerns that may be identified.

The bill would allow the EITC to be refunded if there is an appropriation. The bill fails to specify how the credit would be treated where an appropriation is provided after a taxpayer has filed to carry the credit over. It is unclear, if a taxpayer could amend their return to claim a refund. The bill should be amended to address this issue.

The bill fails to specify how the portion of the credit that is not refunded to a taxpayer because of an inadequate appropriation is to be treated in future taxable years. If after an inadequate appropriation is made, and there are no future appropriations ever made to refund the refundable amount of the credit to those taxpayers on the waiting list, a taxpayer may be prevented from using the refundable portion of the credit to offset tax. To prevent this outcome, it is recommended that the bill be amended to specify how the portion of the credit not refunded to a taxpayer because of an inadequate appropriation should be treated.

Relying on the EITC under federal law may present implementation problems for Registered Domestic Partners (RDPs). RDPs are required to file California income tax returns using the rules applicable to married individuals. If the author's intent is to allow EITC for RDPs, a rule should be included in the bill to address the difference between federal and state law.

Many personal income taxpayers eligible for the federal EITC have no California income tax return filing requirement. These nonfilers would be required to file a California income tax return to claim the proposed state EIC, which could impact the department's programs and costs.

Typically, refund returns are filed early in the filing season. If taxpayers claiming the California EITC file late in the filing season, after they receive their federal EITC, 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 and fraudulently claimed federal EITC cause the IRS to adjust many returns. Consequently, the correct federal EITC amount may be unknown until after the taxpayer has filed the state return, claimed the proposed California credit, and received a refund. The FTB could be required to issue an assessment to retrieve incorrect refunds and incur costs to do so.

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[3] Government Code Section 11340 et seq.

Historically, the department has had significant problems with refundable credits and fraud. These problems are aggravated when a refund is made that 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 regarding fraud.

FISCAL IMPACT

This bill would require instructions and a calculation for the credit that would require a new form or worksheet to be developed. The bill would also require the FTB to establish and maintain a waitlist of taxpayers, notify taxpayers of an appropriation, and notify taxpayers if they have been placed on the waitlist. As a result, this bill would impact the department's programming, printing, processing, mailing, and storage costs for tax returns. The additional costs have not been determined at this time. As the bill continues to move through the legislative process, costs will be identified, and an appropriation will be requested, if necessary.

ECONOMIC IMPACT

Revenue Estimate

This bill would result in the following revenue losses:

Estimated Revenue Impact of AB 1974 For Taxable Years Beginning On or After January 1, 2012 Enactment Assumed After June 30, 2012 ($ in Millions)			
	2012-13	2013-14	2014-15
Assuming No Appropriation	-$110	-$100	-$110
Assuming An Appropriation Is Made	-$1,000	-$900	-$900

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

LEGAL IMPACT

This bill contains provisions that would target certain incentives to residents of California while denying the same incentives to nonresidents. The U.S. Supreme Court in *Lunding Et Ux. v. New York Appeals Tribunal et al.* (1998) 118 S. Ct. 766, found that denying a tax benefit to a nonresident taxpayer, while allowing such a benefit to resident taxpayers, was discriminatory and thus unconstitutional. Consequently, an EIC conditioned on full-year residency in California may be subject to constitutional challenge.

SUPPORT/OPPOSITION[4]

Support: California Catholic Conference, California Family Resource Association, California Federation of Teachers, Catholic Charities of California United.

Opposition: California Taxpayers' Association.

LEGISLATIVE STAFF CONTACT

Brian Werking
Legislative Analyst, FTB
(916) 845-5103
brian.werking@ftb.ca.gov

Gail Hall
Legislative Director, FTB
(916) 845-6333
gail.hall@ftb.ca.gov

[4] As provided in the Assembly Committee on Revenue and Taxation's analysis of the bill as amended March 26, 2012, at < http://www.leginfo.ca.gov/pub/11-12/bill/asm/ab_1951-2000/ab_1974_cfa_20120511_121648_asm_comm.html> [as of May 18, 2012].