Franchise Tax Board

ANALYSIS OF ORIGINAL BILL

Author:	Grove	Analyst:	Diane Deatherage	Bill Number:	AB 673
Related Bills:	See Program Background	Telephone:	845-4783	Introduced Date:	February 21, 2013
		Attorney:	Patrick Kusiak	Sponsor:	

SUBJECT: Personal Exemption Credit/Expected Child

SUMMARY

This bill would provide an exemption credit for a taxpayer's expected child.

RECOMMENDATION

No position.

REASON FOR THE BILL

The reason for this bill is to provide financial relief to expectant families, by allowing an exemption credit for an expected child and to bring consistency to the state's recognition of an unborn child as a person.

EFFECTIVE/OPERATIVE DATE

As a tax levy, this bill would be effective immediately upon enactment and operative for taxable years beginning on or after January 1, 2013.

ANALYSIS

FEDERAL/STATE LAW

Overview

Federal and state law both provide "personal-exemption" type reductions to tax; however, federal law provides a "personal-exemption" deduction, whereas the state provides "personal-exemption" tax credits. An exemption deduction is a reduction to adjusted gross income (AGI) to arrive at taxable income, whereas a tax credit is a dollar-for-dollar reduction to tax.

Federal Law

Federal law provides a "personal-exemption" deduction.[1] There are two types of exemptions: personal exemptions and exemptions for dependents.

[1] Internal Revenue Code (IRC) section 151.

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On a joint return, two personal exemptions would be allowed (taxpayer and spouse). Taxpayers are generally allowed one exemption for each qualifying dependent. Each exemption is worth the same amount, and taxpayers multiply the total number of exemptions by the current-year exemption amount. The exemption deduction is $3,800 for taxable year 2012, and is adjusted annually based on the Consumer Price Index published by the Department of Labor.

For federal purposes, a taxpayer can take the entire exemption deduction amount for a baby that is born during the year, including December 31. A taxpayer may be able to claim an exemption for a child born alive during the year, even if the child lived only for a moment. There must be proof of a live birth shown by an official document, such as a birth certificate. The child must be a qualifying child or qualifying relative, and meet all the other dependent tests in order to qualify for the exemption deduction.

State Law

Generally, individual taxpayers are allowed "personal-exemption" tax credits, as shown below:[2]

Exemption Type	**Number of Exemptions**	**Exemption Amount[3]**
		2012
Personal Exemption	One exemption for themselves, and one for a spouse, if married filing joint (MFJ).	$104
Senior	One additional exemption if 65 or older, and one for a spouse 65 or older, if MFJ.	$104
Blind	One additional exemption if visually impaired and one for a visually impaired spouse.	$104
Dependent	One exemption for each qualifying dependent.	$321

The exemption credits are reduced if a taxpayer's federal AGI exceeds a threshold amount.[4] For taxable year 2012, the exemption credits are reduced if federal AGI is more than:

- Single or Married/Registered Domestic Partner (RDP) filing separate $169,730
- Married/RDP filing joint $339,464
- Head of Household $254,599

THIS BILL

This bill would allow an exemption credit of $321, subject to a specified adjustment for inflation, for an expected child of a qualified taxpayer.

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[2] R&TC section 17054.
[3] The exemption credits are adjusted annually based on the California Consumer Price Index.
[4] The phase-out thresholds are adjusted annually based on the California Consumer Price Index.

The bill would define various terms including the following:

- "Expected child" means an unborn child with a medically verified anticipated delivery date for the subsequent taxable year.
- "Qualified taxpayer" means any of the following:
  - A single individual who is pregnant with an expected child.
  - A married individual making a separate return who is pregnant with an expected child.
  - A head of household who is pregnant with an expected child.
  - A married couple making a joint return in which the married couple has an expected child.

Under this bill, if the expected child is born in the taxable year, only one exemption credit would be allowed.

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 phrase "unborn child" and "medically verified anticipated delivery date" are undefined. The absence of the meanings of these phrases to clarify these terms could lead to disputes with taxpayers and would complicate the administration of this exemption credit.

It is unclear if a pregnant unmarried woman with no other dependent children could qualify under "head of household" status for California purposes if she is pregnant for longer than six months of the tax year.

The bill specifies that the credit shall apply only if the expected child, if born, would qualify as a dependent of the taxpayer for the taxable year the credit is claimed. Because the qualified taxpayer must provide more than half of the expected child's support in order for the expected child to qualify as a dependent, and in some situations (e.g., surrogacy, arranged adoption) this may be unclear, the author may wish to consider amending this bill.

The bill is silent on the treatment of expected multiple births. If it is the author's intent that an exemption credit would be allowed for each expected child in the case of an expected multiple birth, it is suggested that this bill be amended.

This bill would allow an exemption credit for an expected child regardless of whether the pregnancy resulted in a live birth. If this is contrary to the author's intention, this bill should be amended.

The definition of "qualified taxpayer" omits the filing status “surviving spouse” (also referred to as “qualifying widower”) who is pregnant with an expected child. The author may wish to consider adding the omitted filing status under the "qualified taxpayer" definition.

PROGRAM BACKGROUND

AB 1640 (Mitchell, Chapter 778, Statutes of 2012) allows a pregnant minor to qualify for welfare benefits upon verification of pregnancy. This bill applies the precedent from AB 1640 to a pregnant woman to qualify for exemption credits upon verification of pregnancy, and applies the same criteria established by AB 1640 to the determination of eligibility for an exemption credit.

OTHER STATES' INFORMATION

The states surveyed include *Florida, Illinois, Massachusetts, Michigan, Minnesota, and New York.* These states were selected due to their similarities to California's economy, business entity types, and tax laws.

Florida, Illinois, Massachusetts, Minnesota, and *New York* laws do not provide an exemption credit comparable to the exemption credit allowed by this bill.

On May 29, 2012, a *Michigan* bill[5] was introduced that would allow taxpayers to claim a dependency exemption for a fetus that has completed at least 12 weeks of gestation as of the last day of the tax year and that has been under the care and observation of a physician since at least 12 weeks of gestation. The period of gestation would have to be determined by a physician.

FISCAL IMPACT

Department staff is unable to determine the costs to administer this bill until the implementation concerns have been resolved, but anticipate the costs to be significant.

ECONOMIC IMPACT

<u>Revenue Estimate</u>

Estimated Revenue Impact of AB 673 As Introduced February 21, 2013 For Taxable Years Beginning On or After January 1, 2013 Assumed Enactment After June 30, 2013 ($ in Millions)		
2013-14	2014-15	2015-16
-$130	-$80	-$85

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

SUPPORT/OPPOSITION

Support: None provided.

Opposition: None provided.

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[5] Michigan House Bill 5684.

ARGUMENTS

Proponents: Some could argue that this bill would better match the eligibility for dependent tax benefits with the financial impact of an additional dependent and would be consistent with the state's public benefits eligibility criteria for dependents.

Opponents: Some taxpayers may say that with the state's current fiscal crisis, additional tax expenditures should be avoided.

POLICY CONCERNS

This bill would create differences between federal and California tax law, thereby increasing the complexity of California tax return preparation and causing administrative issues with federal adjustments because the Franchise Tax Board matches federal dependents with California dependents in an automated program.

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