Franchise Tax Board

ANALYSIS OF ORIGINAL BILL

Author:	Liu, DeSaulnier, et al.	Analyst:	Jessica Deitchman	Bill Number:	SB 1189
Related Bills:	See Legislative History	Telephone:	845-6310	Introduced Date:	February 20, 2014
		Attorney:	Bruce Langston	Sponsor:	

SUBJECT: Earned Income Credit/15 Percent of Federal Credit

SUMMARY

This bill would, under the Personal Income Tax Law (PITL), create a nonrefundable California credit for residents and nonresidents.

RECOMMENDATION

No position.

REASON FOR THE BILL

The reason for the bill is to encourage employment and provide tax relief and financial support to low-income taxpayers.

EFFECTIVE/OPERATIVE DATE

As a tax levy, this bill would be effective immediately upon enactment and specifically operative for taxable years beginning on or after January 1, 2015.

ANALYSIS

<u>FEDERAL/STATE LAW</u>

Existing federal law allows eligible individuals a refundable earned income credit (EIC). A refundable credit allows for the excess of the credit over the taxpayer's tax liability to be refunded to the taxpayer. The credit is a percentage of the taxpayer's earned income and is phased out as income increases. The percentage varies, based on whether the taxpayer has qualifying children.

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The federal credit for the 2013 taxable year varies from 7.65 percent to 45 percent, depending on filing status and the number of qualifying children. The income phase-outs for 2013 are:

An eligible individual with:	Completely Phased-Out at[1]:
No qualifying children	$14,340 ($19,680 if married filing jointly)
1 qualifying child	$37,870 ($43,210 if married filing jointly)
2 or more qualifying children	$43,038 ($48,378 if married filing jointly)
3 or more qualifying children	$43,227 ($51,567 if married filing jointly)

Married individuals are eligible for only one credit on their combined earned income and must file a joint return to claim the credit.

Existing federal law specifies that if the federal EIC was denied and the Internal Revenue Service (IRS) determined that the taxpayer's error was due to reckless or intentional disregard of EIC rules, the EIC would be denied for the next two years. If the error was due to fraud, the denial period would be ten years.

Under provisions of federal law (Title IV of the Personal Responsibility and Work Opportunity Reconciliation Act of 1996 (P.L. 104-193)), certain individuals not lawfully admitted for permanent residence in the United States are ineligible for federal, state, and local public benefits, including the EIC. IRS implementation of Title IV is limited to verifying eligibility on the basis of social security numbers. The IRS delays all returns claiming the federal EIC that do not pass an automated social security number verification process. By its terms, this federal law applies to states that allow an EIC.

California does not provide an EIC. Existing state laws provide various tax credits designed to provide tax relief for taxpayers that incur certain expenses (e.g., child and dependent care credits), to influence business practices and decisions or to achieve social goals. Credits are allowed against net tax based on a set order of priority as specified in the Revenue and Taxation Code.

Under state law, individuals with income below the filing thresholds are not required to file an income tax return because the standard deduction and personal exemption credit eliminate any tax liability. For 2013, these thresholds are $15,702 in gross income or $12,562 in adjusted gross income (AGI) for single taxpayers and $31,406 in gross income or $25,125 in AGI for married filing joint taxpayers. These thresholds are increased based on the number of dependents claimed and are increased annually for inflation.

[1] The maximum amount of investment income a taxpayer can have and still get the credit is $3,300 in 2013.

THIS BILL

For taxable years beginning on or after January 1, 2015, this bill would provide a nonrefundable state EIC, equal to 15 percent of the federal EIC, as amended by Public Law 112-240.[2]

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 taxpayer error rate and fraud concerns on the federal EIC cause the IRS to adjust many returns. Consequently, the correct federal EIC amount may be unknown until after the taxpayer has filed the state return, claimed the proposed California credit, and received a refund. The Franchise Tax Board (FTB) would be required to issue assessments to correct and collect tax due as result of a change to the federal EIC.

Relying on the EIC 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 an EIC for RDPs, a rule should be included in the bill to address the difference between federal and state law.

TECHNICAL CONSIDERATIONS

The definition of "federal earned income credit amount" would mean the amount determined under Section 32 of the IRC as that section reads as amended by Public Law 112-240. It would be clearer to the reader if "as that section reads as amended by Public Law 112-240" was deleted and replaced with "as in effect as of January 1, 2014."

LEGISLATIVE HISTORY

AB 1196 (Allen, 2011/2012), would have provided a refundable EIC equal to 15 percent of the federal EIC. AB 1196 failed to pass out of the Assembly Appropriations Committee.

AB 21 (Jones, 2007/2008), would have established a nonrefundable EIC equal to 5 percent of the federal EIC. AB 21 failed to pass out of the Assembly Appropriations Committee.

SB 224 (Cedillo, 2003/2004), would have provided a refundable EIC equal to 15 percent of the federal EIC. SB 224 failed to pass out of the Senate Revenue & Taxation Committee.

AB 106 (Cedillo, 2001/2002), would have provided a refundable EIC equal to 15 percent of the federal EIC. AB 106 failed to pass out of the Assembly Appropriations Committee.

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[2] The most recent change to the federal EIC was made on January 2, 2013, under Section 101(a) of the American Taxpayer Relief Act of 2012 (Public Law 112-240).

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 does not have personal income tax, and therefore does not provide a tax credit comparable to the credit proposed by this bill.

Illinois allows taxpayers to claim a refundable credit equal to 10 percent of their federal EIC.

Massachusetts allows taxpayers to claim a refundable credit equal to 15 percent of their federal EIC.

Michigan allows taxpayers to claim a refundable credit equal to 6 percent of their federal EIC.

Minnesota allows taxpayers to claim a Working Family Credit (WFC) if they also claimed the federal EIC. The WFC is based on either the federal earned income or the federal AGI depending on whichever amount is smaller.

New York allows taxpayers to claim a refundable credit equal to 30 percent of the federal EIC.

FISCAL IMPACT

Costs to administer this bill 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

<u>Revenue Estimate</u>

Estimated Revenue Impact of SB 1189 As Introduced February 20, 2014 For Taxable Years Beginning On or After January 1, 2015 Enactment Assumed After June 30, 2015 ($ in Millions)		
2014-15	2015-16	2016-17
- $24	- $120	- $130

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.

ARGUMENTS

Proponents: Some may say that in a time in which many low-income outreach programs are being cut it is important to provide financial assistance to these affected groups, as this bill would accomplish.

Opponents: Some may argue that providing a tax credit limited to low-income recipients may be overly narrow and inadvertently exclude other Californians that need assistance.

POLICY CONSIDERATIONS

This bill lacks carryover language. As a result, any unused credit would be lost if the taxpayer is unable to use the entire credit amount in the year claimed. The author may wish to add language allowing a limited carryover period.

LEGISLATIVE STAFF CONTACT

Jessica Deitchman	Mandy Hayes	Gail Hall
Legislative Analyst, FTB	Revenue Manager, FTB	Legislative Director, FTB
(916) 845-6310	(916) 845-5125	(916) 845-6333
jessica.deitchman@ftb.ca.gov	mandy.hayes@ftb.ca.gov	gail.hall@ftb.ca.gov