

## BILL ANALYSIS

Department, Board, Or Commission	Author	Bill Number
<b>Franchise Tax Board</b>	<b>Monning, et al.</b>	<b>SB 1073</b>

### SUBJECT

Refundable Earned Income Tax Credit (EITC)

### SUMMARY

This bill would, under the Personal Income Tax Law (PITL), conform the California EITC to recent federal changes.

### REASON FOR THE BILL

The reason for this bill is to permanently retain the enhanced 45-percent credit rate for three or more qualifying children.

### EFFECTIVE/OPERATIVE DATE

This bill would be effective January 1, 2017, and specifically operative for taxable years beginning on or after January 1, 2016.

### FEDERAL/STATE LAW

#### *Federal Law*

Existing federal law (Internal Revenue Code (IRC) section 32) allows eligible individuals a refundable EITC. A refundable credit allows for the excess of the credit over the taxpayer's tax liability to be refunded to the taxpayer. The EITC is a percentage of the taxpayer's earned income and is phased out as income increases. The credit percentage varies, based on whether the taxpayer has qualifying children.

For the 2015 taxable year, the following credit percentages apply:

- Three permanent credit and phaseout rates included in the credit table:

In the case of an eligible individual with:	The credit percentage is:	The phaseout percentage is:
No qualifying children	7.65%	7.65%
1 qualifying child	34%	15.98%
2 qualifying children	40%	21.06%

- A temporary enhanced 45-percent credit rate for three or more qualifying children.<sup>1</sup>

Beginning with the 2016 tax year, the enhanced federal 45-percent credit rate was made permanent and added to the permanent credit-rate table (shown below). The paragraph that contained the temporary enhanced 45-percent credit rate was repealed.<sup>2</sup>

In the case of an eligible individual with:	The credit percentage is:	The phaseout percentage is:
No qualifying children	7.65%	7.65%
1 qualifying child	34%	15.98%
2 qualifying children	40%	21.06%
3 or more qualifying children	45%	21.06%

**State Law**

Beginning with the 2015 taxable year, state law provides a refundable California EITC that is generally determined in accordance with IRC section 32 as applicable for federal income tax purposes for the taxable year, except as modified.<sup>3</sup>

State law, in lieu of the above federal credit-rate table, substitutes its own credit-rate table with a maximum credit and phaseout rate of 40-percent.

In the case of an eligible individual with:	The credit percentage would be:	The phaseout percentage would be:
No qualifying children	7.65%	7.65%
1 qualifying child	34%	34%
2 qualifying children	40%	40%

State law, for taxable year 2015, also provides an enhanced 45-percent credit and phaseout for three or more qualifying children.

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<sup>1</sup> The enhancements to the federal EITC (including the 45-percent credit rate) started as a temporary two-year provision in 2009, and were included in paragraph (3) of IRC section 32(b), and paragraph (3) was modified each time the federal EITC enhancements were extended.

<sup>2</sup> Section 103 of the Protecting Americans from Tax Hikes Act of 2015 (Division Q of Public Law 114-113).

<sup>3</sup> Revenue and Taxation Code section 17052. The California EITC is only operative for taxable years the annual Budget Act specifies an adjustment factor and authorizes resources for the FTB to oversee and audit returns associated with the California EITC. For additional details on the California EITC, refer to [www.ftb.ca.gov](http://www.ftb.ca.gov).

For taxable years beginning on or after January 1, 2016, the 45-percent credit rate expires and the maximum California credit rate will be 40 percent.<sup>4</sup>

## **THIS BILL**

For taxable years beginning on or after January 1, 2016, this bill would, under the PITL, make permanent the California EITC's 45-percent credit rate for three or more qualifying children by adding the enhanced rate to the permanent credit table, consistent with recent federal changes.

## **LEGISLATIVE HISTORY**

AB 1847 (Stone, et al., 2015/2016) would amend *The Earned Income Tax Credit Information Act*. This bill is pending before the Governor.

AB 1929 (Brough, 2015/2016) would modify the Franchise Tax Board's (FTB) annual report to the Legislature on the California EITC. This bill was held in the Assembly Revenue and Taxation Committee.

AB 2807 (Steinorth and Lackey, 2015/2016) would expand the California EITC to allow some self-employed individuals to claim the credit. This bill was held in the Assembly Revenue and Taxation Committee.

SB 80 (Committee on Budget and Fiscal Review, Chapter 21, Statutes of 2015) created the refundable California EITC for taxable years beginning on or after January 1, 2015.

## **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 a 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 EITC.

*Massachusetts* allows taxpayers to claim a refundable credit equal to 15 percent of their federal EITC. The 15-percent credit rate will increase to 23 percent beginning with taxable year 2016.

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<sup>4</sup> California law provides that that the federal credit-rate table shall not apply, and in lieu provides its own credit-rate table without the enhanced 45-percent credit rate. California law provides a modification that was intended to conform to any subsequent "extensions" of the federal enhanced 45-percent credit rate with a modified credit phaseout amount, but that enhanced rate and modification no longer apply for California purposes after 2015 because instead of temporarily extending the 45-percent credit rate, Congress instead restructured IRC section 32(b) to make the 45-percent credit rate permanent and repealed the temporary paragraph (3).

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

*Minnesota* allows taxpayers to claim a Working Family Credit (WFC) if they also claimed the federal EITC. The WFC is based on the lesser of either the federal EITC or federal AGI.

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

## **FISCAL IMPACT**

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

## **ECONOMIC IMPACT**

### **Revenue Estimate**

This bill would result in the following revenue loss:

Estimated Revenue Impact of SB 1073 Assumed Enactment After June 30, 2016 (\$ in Millions)		
2016-17	2017-18	2018-19
- \$5.1	- \$5.4	- \$5.6

This analysis does not account for changes in employment, personal income, or gross state product that could result from this bill. In addition, this estimate only reflects the revenue impact to income and franchise taxes.

### **Revenue Discussion**

This estimate is derived from preliminary 2015 tax return data of 380,000 returns claiming the EITC credit as of the end of June 2016. The taxpayer EITC eligibility and amounts are calculated based on filing status, income, and number of dependents claimed. The EITC estimate is based on current law parameters for phase-in, phaseouts, earned income, investment income, and federal adjusted gross income (AGI). Taxpayer EITC eligibility and amounts were calculated twice: once allowing a 40-percent credit and phaseout percentage for returns with two or more qualifying children, and, then, a second time allowing a 45-percent credit and phaseout percentage for returns with three or more qualifying children. The difference is the impact of including the 45-percent rate in the EITC table. The results using 2015 tax return data were then adjusted to reflect changes in the economy over time.

The estimated revenue loss per tax year attributable to including the 45-percent credit percentage in the California EITC table is approximately \$5 million.

The tax year estimates are converted to fiscal year estimates, and then rounded to arrive at the amounts reflected in the above table.

**APPOINTMENTS**

None.

**SUPPORT/OPPOSITION**

Support: None provided.

Opposition: None noted.

**VOTES**

	<b>Date</b>	<b>Yes</b>	<b>No</b>
Concurrence	08/30/16	39	0
Assembly Floor	08/25/16	78	0
Senate Floor	06/01/16	33	2

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