Franchise Tax Board

ANALYSIS OF ORIGINAL BILL

Author:	Liu	Analyst:	Jessica Deitchman	Bill Number:	SB 38
Related Bills:	See Legislative History	Telephone:	845-6310	Introduced Date:	December 1, 2014
		Attorney:	Bruce Langston	Sponsor	

SUBJECT:	Earned Income Tax Credit/15 Percent of Federal Credit

SUMMARY

This bill would, under the Personal Income Tax Law (PITL), create a nonrefundable California earned income 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, 2016, and before January 1, 2027.

FEDERAL/STATE LAW

Federal Law

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.

The federal credit rate for the 2014 taxable year varies from 7.65 percent to 45 percent, depending on filing status and the number of qualifying children. The 2014 Adjusted Gross Income (AGI) amount at which the EIC is completely phased out is:

Board Position:						Executive Officer	Date
	S		NA	X	NP	Selvi Stanislaus	1/21/15
	SA		O		NAR		
	N		OUA				

An eligible individual with :	Completely Phased-Out at[1]:
No qualifying children	$14,590 ($20,020 if married filing jointly)
1 qualifying child	$38,511 ($43,941 if married filing jointly)
2 or more qualifying children	$43,756 ($49,941 if married filing jointly)
3 or more qualifying children	$46,997 ($52,427 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.

State Law

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 2014, these filing thresholds are $16,047 in gross income or $12,838 in AGI for single taxpayers and $33,097 in gross income or $25,678 in AGI for married filing joint taxpayers. These filing 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 $3,350 in 2014.

THIS BILL

For taxable years beginning on or after January 1, 2016, and before January 1, 2027, this bill would provide a nonrefundable state EIC, equal to 15 percent of the federal EIC.[2]

Additionally, this bill would require the Franchise Tax Board (FTB) to provide a report to the legislature on or before January 1, 2026 that would include the following information:

- Information regarding the effectiveness of the credit,
- The amount of the credit claimed,
- The number of claims made, and
- An estimate of the amount overclaimed and underclaimed.

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.

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, but federal law lacks this requirement. 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.

The bill would require the FTB to report to the Legislature the "effectiveness of the credit" and the amount "overclaimed and underclaimed." These terms are undefined in the bill. Without a definition, the term could be broadly interpreted and the department may not be able to capture and report the information intended.

The bill provides that the credit would be computed as a percentage of the federal EIC as it is amended by Section 1002(a) of Public Law 111-5, as amended by Section 219(a)(2) of Public Law 111-226, as amended by Section 103(c) of Public Law 111-312, and as amended by Section 103(c) of Public Law 112-240. To avoid potential confusion among taxpayers on which version of the federal EIC the state credit is based off of, it is recommended that the bill be amended to state that the California credit is based off of the federal credit as it is in effect in any taxable year.

[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).

LEGISLATIVE HISTORY

SB 1189 (Liu, 2013/2014), would have provided a nonrefundable EIC equal to 15 percent of the federal EIC. SB 1189 failed to pass out of the Senate Appropriations Committee.

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.

PROGRAM BACKGROUND

On December 18, 2014, California's Legislative Analyst's Office issued a report on the "Options for a State Earned Income Tax Credit."[3] This report discussed the option to "piggyback" on the federal EIC.

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.

---

[3] http://www.lao.ca.gov/reports/2014/finance/state-eitc/options-state-eitc-121814.pdf.

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

Revenue Estimate

This bill would result in the following revenue losses:

Estimated Revenue Impact of SB 38 As Introduced December 1, 2014 Assumed Enactment After June 30, 2015 ($ in Millions)		
2015-16	2016-17	2017-18
- $26	- $130	- $130

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

Revenue Discussion

This bill would establish a nonrefundable California Earned Income Tax Credit (CA EITC) that is 15 percent of the federal EIC. California taxpayers claimed approximately $7.5 billion in federal EIC in the 2012 tax year. As such, the CA EITC would be 15 percent of the federal EIC, or approximately $1 billion. Using IRS statistics, it is estimated that only 10 percent, or $100 million, of the credits earned would be used to offset tax. This total is grown using the Department of Finance personal income tax growth rates, fiscalized, and rounded to reach the numbers in the table above.

SUPPORT/OPPOSITION

Support: None provided.

Opposition: None provided.

ARGUMENTS

Proponents: Some may say that in a time when many families are living in poverty, this credit would provide financial assistance to these low income families.

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.

LEGISLATIVE STAFF CONTACT

Jessica Deitchman
Legislative Analyst, FTB
(916) 845-6310
jessica.deitchman@ftb.ca.gov

Mandy Hayes
Revenue Manager, FTB
(916) 845-5125
mandy.hayes@ftb.ca.gov

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