BILL ANALYSIS

Department, Board, Or Commission	Author	Bill Number
Franchise Tax Board	**Assembly Committee on Budget**	**AB 131**

SUBJECT: Technical Clarification/ Earned Income Refundable Credit/ Revise Minimum Voluntary Contribution Amount Requirement/ Office of Tax Appeals

SUMMARY

This bill would do the following:

Provision No. 1: Provide technical clarification for the California Earned Income Tax Credit (California EITC).

Provision No. 2: Provide technical clarification for the revised minimum voluntary contribution amount requirement for the 2017 Calendar Year.

Provision No. 3: Make clarifying and conforming changes with regard to the transfer of duties from the State Board of Equalization (Board) to the Office of Tax Appeals (Office).

This analysis only addresses the provisions of the bill that would impact the department's programs and operations.

REASON FOR THE BILL

The reason for this bill is to provide technical clarification to recently enacted budget trailer bills related to the 2017 Annual Budget Act.

EFFECTIVE/OPERATIVE DATE

This bill, providing for appropriations related to the Budget Bill and identified as a bill related to the budget in the Budget Bill, would be effective immediately upon enactment. The operative dates of the provisions vary and are addressed separately below.

Provision No. 1: The modifications to the California EITC would be specifically operative for taxable years beginning on or after January 1, 2017.

Provision No.2: The suspension of the minimum voluntary contribution requirements would be specifically operative for the 2017 calendar year.

Provision No. 3: The modifications to the Board, California Department of Tax and Fee Administration (CDTFA), and Office would be operative as specified.

PROVISION NO. 1: Provide Technical Clarifications for the California Earned Income Tax Credit (California EITC)

FEDERAL LAW

Existing federal law (Internal Revenue Code (IRC) section 32) allows eligible individuals a refundable Earned Income Tax Credit (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 federal credit rate varies from 7.65 percent to 45 percent, depending on the number of qualifying children.

The 2016 earned income amounts at which the EITC is completely phased-out and the maximum credit amounts are shown below:

An eligible individual with:	Completely Phased-Out at:[1]	2016 Max. Credit
No qualifying children	$14,880 ($20,430 if married filing jointly)	$506
1 qualifying child	$39,296 ($44,846 if married filing jointly)	$3,373
2 qualifying children	$44,648 ($50,198 if married filing jointly)	$5,572
3 or more qualifying children	$47,955 ($53,505 if married filing jointly)	$6,269

STATE LAW

State law, beginning with the 2015 taxable year, allows a refundable California EITC in an amount equal to an amount determined in accordance with IRC section 32 as applicable for federal income tax purposes for the taxable year, except as modified.

The California EITC is only operative for taxable years for which resources are authorized in the Annual Budget Act for the Franchise Tax Board (FTB) to oversee and audit returns associated with the credit. The Legislature also must establish the California EITC adjustment factor for each taxable year; otherwise the California EITC adjustment factor is zero. For 2016 and 2017, the California EITC adjustment factor is 85 percent.

[1] Under IRC section 32(a)(2)(B), the credit is phased-out based on adjusted gross income (AGI), or, if greater, the earned income.

For purposes of the California EITC, the federal definition of "earned income" is modified to include wages, salaries, tips, and other employee compensation, includable in federal AGI, but only if such amounts are subject to California withholding.[2] For taxable years beginning on or after January 1, 2015, and before January 1, 2017, earned income specifically excluded net earnings from self-employment.

For taxable years beginning on or after January 1, 2017, the California EITC was modified to include, in the definition of earned income, net earnings from self-employment, consistent with federal law.

For purposes of computing the California EITC, the following earned income and phaseout table is used in lieu of the federal table:

In the case of an eligible individual with:	Earned Income Amount (maximum credit fully phased-in)	The Phaseout Amount:
No qualifying children	$3,290	$3,290
1 qualifying child	$4,940	$4,940
2 or more qualifying children	$6,935	$6,935

The earned income and phaseout amounts are adjusted annually for inflation in the same manner as the recomputation of the state income tax brackets.

For taxable year 2017, the maximum AGI phaseout amounts for the California EITC were increased by substituting new tables for the credit and phaseout percentages and the earned income and phaseout amounts after the credit amount phases down to $100[3] or less for a taxpayer with no qualifying children or $250 or less for a taxpayer with one or more qualifying children.

For 2017, the California EITC would generally be available to households with AGI of less than:

- $15,009 if there are no qualifying children,[4]
- $22,301 if there are one or more qualifying children (the approximate full-time, state minimum wage as of January 1, 2017).[5]

[2] Pursuant to Division 6 (commencing with section 13000) of the Unemployment Insurance Code.
[3] The $100 and $250 credit amounts are determined after applying the EITC adjustment factor.
[4] The California EITC would generally phaseout at a decreased rate between AGI of $5,354 and $15,009.
[5] The California EITC would generally phaseout at a decreased rate as follows:
For one qualifying child, between AGI of $9,484 and $22,301.
For two qualifying children, between $13,794 and $22,301.
For three or more qualifying children between $13,875 and $22,301.

THIS PROVISION

For taxable years beginning on or after January 1, 2017, this provision would, under the Personal Income Tax Law, make the following technical corrections to the California EITC enhancements enacted by SB 106 (Committee on Budget and Fiscal Review, Chapter 96, Statutes of 2017):

- Update the tables in subdivision (m) to reflect the actual, rather than the estimated, change in the California Consumer Price Index (CCPI) for tax year 2017.[6]
- Allow the California EITC adjustment factor to vary from 85 percent in future years.[7]
- Make other nonsubstantive technical changes.

LEGISLATIVE HISTORY

SB 116 (Senate Committee on Budget and Fiscal Review, 2017/2018), identical to this bill, would provide technical clarification to previous budget trailer bills related to the 2017 Annual Budget Act. SB 116 is pending on the Assembly Inactive File.

SB 106 (Senate Committee on Budget and Fiscal Review, Chapter 96, Statutes of 2017), expanded the California EITC by modifying the earned income computation to include net earnings from self-employment, consistent with federal law, and increasing the maximum AGI phaseout amounts.

SB 1073 (Monning, Chapter 722, Statutes of 2016) made permanent the enhanced 45-percent credit rate for three or more qualifying children consistent with federal.

SB 80 (Senate Committee on Budget and Fiscal Review, Chapter 21, Statutes of 2015) enacted the California EITC.

OTHER STATES' INFORMATION

The states surveyed include *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.

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 23 percent of their federal EITC.

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

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[6] The actual CCPI for tax year 2017 of 2.6 percent became available after enactment of SB 106.
[7] The EITC adjustment factor for taxable year 2017 is 85 percent; however, the percentage in future years may vary as the percentage is set each year in the Annual Budget Act.

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 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 provision would not significantly impact the department's costs.

ECONOMIC IMPACT

Revenue Discussion

This provision would not impact the state income or franchise tax revenue.

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

PROVISION NO. 2: Provide Technical Clarification for the Revised Voluntary Contribution Amount Requirement for Calendar Year 2017

STATE LAW

Current state tax law allows taxpayers to make contributions of their own monies (not tax liability) on their tax returns to any of the 19 voluntary contribution funds listed on the 2016 state personal income tax return (return).

Generally funds remain on the return until they are either repealed or fail to meet their minimum contribution amount:

The FTB is required to make the following two determinations for each fund by September 1 of each calendar year:

1. The minimum contribution amount required for the fund to remain on the return for the following calendar year, and
2. Whether estimated contributions to the fund will be less than the minimum contribution amount for that calendar year.

If the FTB estimates that contributions to a fund will fail to meet or exceed the minimum contribution amount for a calendar year, that fund is repealed effective January 1 of that calendar year.

Recently enacted law, AB 111, set the minimum contribution amount for the 2017 calendar year with regard to voluntary contribution funds subject to a minimum contribution requirement for the year at zero ($0).

THIS PROVISION

This provision would clarify the minimum contribution amount and make several nonsubstantive technical changes related to AB 111 (Assembly Committee on Budget, Chapter 19, Statutes of 2017).

LEGISLATIVE HISTORY

AB 111 (Assembly Committee on Budget, Chapter 19, Statutes of 2017), specified the minimum voluntary contribution amount requirement for calendar year 2017 as $0.

PROGRAM BACKGROUND

As a result of a tax software vendor programming change, there was a significant decline in voluntary contributions on the 2016 tax returns. Absent enactment of AB 111, most of the funds would have failed to meet the required minimum contribution amount needed to be retained on the 2017 individual income tax return.

OTHER STATES' INFORMATION

Since this provision would make a minor technical clarification to existing state law, a comparison to other states laws would not be relevant.

FISCAL IMPACT

This provision would not impact the department's costs.

ECONOMIC IMPACT

Revenue Estimate

This provision would not impact the state income or franchise tax revenue.

PROVISION NO. 3: Make Clarifying and Conforming Changes with Regard to the Transfer of Duties from the Board to the Office

STATE LAW

The Taxpayer Transparency and Fairness Act of 2017[8] established the Office to provide an independent administrative body to conduct tax appeal hearings.

[8] AB 102, Assembly Committee on Budget, Chapter16, Statutes of 2017.

THIS PROVISION

Under the Government Code, this provision would:

- Clarify that tax appeals would continue in the same manner as they were before the creation of the Board until January 1, 2018.
- Specify that a person requesting relief may request an appeals conference if the appeals panel denies the request for relief.
- Allow the Board and the CDTFA to obtain photographs from the Department of Motor Vehicles.
- Authorize the CDTFA to disclose to specified persons certain information with regard to an action or proceeding affecting the personnel rights of an employee or former employee and specify that unauthorized disclosure by such person of information received from the CDTFA would be subject to criminal penalty and civil liability.

LEGISLATIVE HISTORY

AB 102 (Assembly Committee on Budget, Chapter 16, Statutes of 2017), among other things, established the Office within state government and specified its duties.

OTHER STATES' INFORMATION

Since this provision is specific to the transition of tax appeals and duties of the Office, a review of other state tax laws would not be relevant.

FISCAL IMPACT

This provision would not impact the department's costs.

ECONOMIC IMPACT

This provision would not impact the state's income or franchise tax revenue.

APPOINTMENTS

None.

SUPPORT/OPPOSITION

Support: None noted.

Opposition: None noted.

VOTES

	Date	Yes	No
Concurrence	09/15/17	78	1
Senate Floor	09/15/17	34	4
Assembly Floor	05/18/17[9]	45	25

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[9] The Assembly Floor voted occurred prior to the inclusion of the three provisions discussed above.