



## Analysis of Original Bill

Author: Reyes                                      Sponsor:                                      Bill Number: AB 2387  
Analyst: Davi Milam                              Phone: (916) 845-2551                      Introduced: February 14, 2018  
Attorney: Bruce Langston                      Related Bills: See Legislative  
History

**Subject:** Earned Income Refundable Credit/ Allow to Individuals who are Age 18

### Summary

This bill, under the Personal Income Tax Law (PITL) would modify the California Earned Income Tax Credit (California EITC).

**Recommendation – No position.**

### Reason for the Bill

The reason for this bill is to increase the number of Californians eligible for the California EITC.

### Effective/Operative Date

This bill would be effective January 1, 2019, and specifically operative for taxable years beginning on or after January 1, 2019.

### Federal/State Law

#### 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. For 2017, the EITC is available to individuals and families earning up to \$53,930. The federal credit rate varies from 7.65 percent to 45 percent, depending on the number of qualifying children.<sup>1</sup>

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<sup>1</sup> The maximum credit ranges from \$510 for an eligible individual without a qualifying child up to \$6,318 for an eligible individual with three or more qualifying children.

An eligible individual<sup>2</sup> is defined as follows:

- Any individual who has a qualifying child for the taxable year, or
- Any other individual that does not have a qualifying child for the taxable year, if they meet the following requirements:<sup>3</sup>
  - Have attained the age of 25 but not attained the age of 65 before the close of the taxable year.
  - Have a principal place of abode in the United States for more than one-half the taxable year.
  - Not be a dependent of another taxpayer.

Certain individuals are specifically excluded from the definition of an eligible individual.<sup>4</sup>

Generally, a qualifying child must live with the eligible individual for more than one-half the taxable year in the United States, and must be under the age of 19, unless the child is a full-time student under age 24, or the child is permanently and totally disabled. Only one person can claim a qualifying child.

The name, age, and Social Security Number (SSN) of the qualifying child must be reported on the tax return.

## State Law

Beginning with the calendar year 2015 tax 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>5</sup>

State law conforms to the federal definitions of an “eligible individual” and a “qualifying child” with the following exceptions:

- An eligible individual without a qualifying child must have a principal place of abode in “this state” (rather than the United States) for more than one-half of the taxable year.
- A qualifying child also must have a principal place of abode in “this state” (rather than the United States) for more than one-half of the taxable year.

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<sup>2</sup> IRC section 32(c)(1).

<sup>3</sup> IRC section 32(c)(1)(A)(ii).

<sup>4</sup> IRC section 32(c)(1) excludes from the definition of an eligible individual: an individual who is a qualifying child of another taxpayer; U.S. citizens or residents living abroad and claiming benefits under IRC section 911, and most nonresident aliens, unless they elect to be treated as US residents for federal tax purposes.

<sup>5</sup> Revenue and Taxation Code (R&TC) section 17052. The California EITC is only operative for taxable years the annual Budget Act specifies an adjustment factor and authorizes resources for the Franchise Tax Board (FTB) to oversee and audit returns associated with the California EITC. For additional details on the California EITC, refer to the [Franchise Tax Board home page](#).

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 Annual Gross Income (AGI), but only if such amounts are subject to California withholding.<sup>6</sup> 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, and to increase the maximum AGI amounts at which the California EITC is completely phased-out.

For 2017, the California EITC is available to households with AGI of up to:

- \$15,008 if there are no qualifying children,
- \$22,322 if there is one or more qualifying child (the approximate full-time, state minimum wage as of January 1, 2017),
- \$22,309 if there are two qualifying children, and
- \$22,302 if there are three or more qualifying children.

### **This Bill**

For taxable years beginning on or after January 1, 2019, this bill, under the PITL, would modify the California EITC by reducing from 25 years to 18 years the minimum age limit for eligible individuals without a qualifying child.

### **Implementation Considerations**

Implementing this bill would require changes to existing tax forms and instructions and information systems.

This bill would create overlapping age ranges for a qualifying child and an eligible individual without a qualifying child, thus increasing the likelihood for improper claims caused by an individual being a qualifying child for another person. For example, a student under age 24 would also meet the age requirement for an eligible individual without a qualifying child and may claim a California EITC when they are also reported as a qualifying child for the California EITC on their parents’ return.

This bill would significantly expand eligibility for the California EITC beyond federal eligibility, thus requiring the department to expand its efforts to identify and deny improper claims.

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<sup>6</sup> Pursuant to Division 6 (commencing with section 13000) of the Unemployment Insurance Code.

## Legislative History

AB 1942 (Santiago, 2017/2018), would require the FTB to modify the Form 540 related to the California EITC, and modify *The EITC Information Act*. AB 1942 is pending before the Assembly Revenue and Taxation Committee.

AB 131 (Assembly Committee on Budget, Chapter 252, Statutes of 2017) provided technical clarification to previous budget trailer bills related to the 2017 Annual Budget Act, including SB 106 discussed below.

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 phase-out 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.

## Program Background

California began offering its own California EITC starting with calendar year 2015 tax returns. This refundable tax credit puts money back in the pockets of California's working families and individuals. For taxpayers who owe taxes, the California EITC reduces the amount of taxes they might owe and may allow them a refund when they file their taxes. If they do not owe taxes, the California EITC will provide them a tax refund when they file their taxes.

To claim the California EITC, eligible taxpayers must file their California personal income tax return<sup>7</sup> and attach Form 3514, *California Earned Income Tax Credit*.<sup>8</sup> Individuals may access [CalEITC4me](#) to find free help to file a 2017 personal tax return through Tax Day, Monday, April 17, 2018.<sup>9</sup>

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<sup>7</sup> Individual income tax returns include the Form 540 *California Resident Income Tax Return*, Form 540 2EZ *California Resident Income Tax Return*, or Form 540-NR *California Nonresident or Part-Year Resident Return*. These forms are available at the [Franchise Tax Board home page](#).

<sup>8</sup> [2017 Form 3514 California Earned Income Tax Credit](#).

<sup>9</sup> If April 15 falls on a Saturday, Sunday, or holiday, the filing deadline is extended to the next working day. April 16, 2018, Emancipation Day, is a legal holiday in Washington DC. Therefore, the 2018 Tax Day is April 17, 2018.

### 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.

*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

The department's costs to implement this bill have yet to be determined. As the bill moves 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 loss:

Estimated Revenue Impact of AB 2387 as Introduced February 14, 2018  
For Taxable Years Beginning On or After January 1, 2019  
Assumed Enactment after June 30, 2018, (\$ in Millions)

Fiscal Year	Revenue
2018-2019	- \$0
2019-2020	- \$27
2020-2021	- \$27

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

## Revenue Discussion

Based on output from the FTB's California EITC microsimulation model comparing current law and proposed law results, it is estimated that in taxable year 2019, expanding the California EITC to taxpayers between the age of 18 and 25 with no dependents would result in a \$27 million revenue loss. The tax year estimates are converted to fiscal years, and then rounded to arrive at the amounts shown in the above table.

## Support/Opposition

Support: None Provided.

Opposition: None Provided.

## Arguments

Proponents: Some may say that this bill, by reducing the age limit, would increase the number of individuals eligible for the California EITC increasing economic security for California's young adults.

Opponents: Some may argue that the reduced age limit that would be provided by this bill would have little impact on the number of taxpayers claiming the California EITC.

## Policy Concerns

This bill would create differences between federal and California eligibility rules for the California EITC, thereby increasing the complexity of California tax return preparation.

## Legislative Staff Contact

Davi Milam  
Legislative Analyst, FTB  
(916) 845-2551  
[davi.milam@ftb.ca.gov](mailto:davi.milam@ftb.ca.gov)

Jame Eiserman  
Revenue Manager, FTB  
(916) 845-7484  
[jame.eiserman@ftb.ca.gov](mailto:jame.eiserman@ftb.ca.gov)

Diane Deatherage  
Legislative Director, FTB  
(916) 845-6333  
[diane.deatherage@ftb.ca.gov](mailto:diane.deatherage@ftb.ca.gov)