



## Analysis of Original Bill

Author: Reyes

Sponsor:

Bill Number: AB 1593

Analyst: Davi Milam

Phone: (916) 845-2551

Introduced: February 22, 2019

Attorney: Shane Hofeling

Related Bills: See Legislative  
History

**Subject:** Earned Income Refundable Tax Credit/ Individual Taxpayer Identification Numbers (ITINs)

### Summary

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

**Recommendation – No position.**

### Reason for the Bill

The reason for this bill is to reduce California poverty by increasing the number of Californians eligible for the California EITC.

### Effective/Operative Date

This bill would be effective January 1, 2020, and would be specifically operative for taxable years beginning on or after January 1, 2019.

### Federal/State 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 2018, the EITC is available to individuals and families earning up to \$ 54,884. 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 \$519 for an eligible individual without a qualifying child up to \$6,431 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.

An eligible individual (and spouse, if filing a joint return) also must have a Social Security Number (SSN) issued by the Social Security Administration that is valid for employment.<sup>4</sup> Certain individuals are specifically excluded from the definition of an eligible individual.<sup>5</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 SSN of the qualifying child must be reported on the tax return.

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>6</sup>

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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(m). The SSN must be issued by the Social Security Administration and must be valid for employment. A social security card stating "Not Valid for Employment" or a federal ITIN may not be used for the federal EITC.

<sup>5</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>6</sup> PITL 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. Refunds for the California EITC are paid from the continuously appropriated Tax Relief and Refund Account. For additional details on the California EITC, refer to the [Franchise Tax Board home page](#).

State law generally conforms, with modification, to the federal definitions of an “eligible individual” and a “qualifying child.” For taxable years beginning on or after January 1, 2018, the age limit for an eligible individual without a qualifying child is 18 years or older, rather than between the ages of 25 and 64 years.

State law conforms to the federal requirement that an eligible individual and any qualifying child must have a valid SSN.

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 Adjusted Gross Income (AGI), but only if such amounts are subject to California withholding. The California EITC includes, in the definition of earned income, net earnings from self-employment, consistent with federal law.<sup>7</sup>

The original earned income and phaseout amounts are adjusted annually for inflation in the same manner as the recomputation of the state income tax brackets using the California Consumer Price Index (CCPI). For taxable years beginning on or after January 1, 2018, and before January 1, 2019, the percentage change in the CCPI is deemed to be the greater of 3.1 percent or the actual change in the CCPI.

For 2018, the California EITC is generally available to households with AGI of less than \$24,950.

### **This Bill**

For each taxable year beginning on or after January 1, 2019, this bill, under the PITL, would modify the California EITC by:

- Fixing the percentage change in the CCPI at the greater of 3.1 percent or the actual change in the CCPI.
- Modifying the requirement that eligible individuals and qualifying children must have an SSN to claim the California EITC by allowing either a federal ITIN or an SSN without regard to being valid for employment.
- Increasing the credit amount as follows:
  - The amount of credit allowed to an eligible individual without a qualifying child, determined in accordance with IRC section 32, as applicable for federal income tax purposes for the taxable year, as modified by this section, would be doubled.

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<sup>7</sup> Since taxable years beginning on or after January 1, 2017, earned income has included self-employment income, consistent with federal law.

- The amount of credit allowed to an eligible individual with a qualifying child, determined in accordance with IRC section 32, as applicable for federal income tax purposes for the taxable year, as modified by this section, would be increased by two hundred fifty dollars (\$250) per qualifying child, up to a maximum of three qualifying children.

### **Implementation Considerations**

Department staff has identified the following implementation considerations for purposes of a high-level discussion; additional concerns may be identified as the bill moves through the legislative process. Department staff is available to work with the author's office to resolve these and other concerns that may be identified.

This bill, by allowing federal ITINs, 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.

Absent an SSN, the department would be unable to accurately match or verify the taxpayer-reported wage and withholding information with employer-reported wages to the Employee Development Department, increasing the likelihood of improper claims.

### **Legislative History**

SB 855 (Senate Committee on Budget and Fiscal Review, Chapter 52, Statutes of 2018), expanded the California EITC by increasing the maximum AGI phaseout amounts, and reducing to 18 years the minimum age limit for eligible individuals without a qualifying child.

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.

AB 2066 (Stone, et al., 2017/2018), would have modified the California EITC by reducing to 18 years the minimum age limit for eligible individuals without a qualifying child, and allowing either a federal ITIN or an SSN. AB 2066 failed to pass by the constitutional deadline.

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 for consistency with the federal EITC.

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 the 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>8</sup> and attach Form 3514, *California Earned Income Tax Credit*.<sup>9</sup> Individuals may access [CalEITC4me](#) to find free help to file a 2018 personal tax return through, April 15, 2019.

## 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 18 percent of their federal EITC.

*Massachusetts* allows taxpayers to claim a refundable credit based on their federal EITC. Beginning with taxable year 2019, the credit percentage increases from 23 to 30 percent.

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

*Minnesota* generally allows taxpayers to claim a Working Family Credit (WFC) if they are eligible for the federal EITC. A taxpayer without a qualifying child who is between the age of 21 and 64, and otherwise eligible for the federal EITC, may also receive the WFC. The WFC is based on the lesser of the federal EITC or federal AGI.

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<sup>8</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>9</sup> [2017 Form 3514 California Earned Income Tax Credit](#).

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.

### **Economic Impact**

#### Revenue Estimate

This bill would result in the following revenue loss:

Estimated Revenue Impact of AB 1593 as Introduced February 22, 2019  
Assumed Enactment after June 30, 2019

(\$ in Millions)

<b>Fiscal Year</b>	<b>Revenue</b>
2019-2020	-\$550
2020-2021	-\$550
2021-2022	-\$600

This analysis does not account for changes in employment, personal income, or gross state product that could result from this bill or for the net final payment method of accrual.

#### Revenue Discussion

Based on output from the FTB's California EITC micro-simulation model comparing current law and proposed law model results, it is estimated that expanding the California EITC to taxpayers with federal ITINs, doubling the credit for taxpayers without any qualifying children, changing the indexing procedure to always use the greater of the CCPI or 3.1 percent, and adding an additional \$250 per qualifying child, up to three qualifying children, to the credit amount would result in a \$550 million revenue loss in taxable year 2019.

The tax-year estimates are converted to fiscal-year estimates and rounded to arrive at the amounts shown in the above table.

## **Policy Concerns**

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

The department is concerned that the proposed use of federal ITINs could lead to an increase in improper claims and payments.

## **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)

Jahna Carlson  
Acting Legislative Director, FTB  
(916) 845-5683  
[jahna.carlson@ftb.ca.gov](mailto:jahna.carlson@ftb.ca.gov)