Analysis of Amended Bill

Author: Burke  Sponsor:  Bill Number: AB 24
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Attorney: Shane Hofeling  Related Bills: See Legislative
                April 22, 2019, and May 1, 2019
History

Subject:  Targeted Child Tax Credit

Summary

This bill, under the Personal Income Tax Law (PITL), would create the Targeted Child Tax
Credit (TCTC).

Recommendation – No position.

Summary of Amendments

The March 26, 2019, amendments replaced legislative intent language with the
provisions creating the TCTC.

The April 22, 2019, amendments modified defined terms, made a number of clarifying
and technical changes to the credit, added an annual reporting requirement, and
added a sunset date.

The May 1, 2019, amendments made additional clarifying and technical changes.

This is the department’s first analysis of this bill.

Reason for the Bill

The reason for this bill is to provide a child tax credit that when fully implemented and
fully claimed would end deep child poverty in California.

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, 2019, and
before January 1, 2024.
Federal/State Law

Child Tax Credit

Federal law allows a Child Tax Credit equal to $2,000 per qualifying child, of which up to $1,400 can be refundable for each qualifying child. The credit applies if the child is younger than 17 at the end of the tax year, has a valid Social Security Number issued before the due date of the tax return, including extensions, and the child lives with the taxpayer for more than six months of the year and can be claimed by the taxpayer as a dependent. The credit is subject to income limits and begins to phase out at $200,000 of modified adjusted gross income, or $400,000 for married couples filing jointly.

State law lacks a comparable Child Tax Credit.

Child and Dependent Care Expenses Credit

Existing federal law allows a Child and Dependent Care Expenses Credit for 20 to 35 percent (depending on the taxpayer's adjusted gross income (AGI)) of employment-related expenses of care for a qualifying individual. A qualifying individual is defined as a dependent of the taxpayer that is under the age of 13, or a dependent or spouse who is physically or mentally unable to provide self-care. Employment-related expenses are generally defined as those expenses incurred to enable gainful employment. These expenses are limited to the lesser of the taxpayer's earned income or $3,000 per taxable year for one qualifying individual, or $6,000 if there are two or more qualifying individuals.

State law allows a Child and Dependent Care Expenses Credit similar to the federal credit. In general, California conforms to federal law regarding qualifying individuals and the maximum amount and types of expenses eligible for the credit. However, state law limits expenses to care provided in California, and for purposes of the earned income limitation, uses earned income from California sources.

The state credit is computed by first applying the federal credit percentage (20 to 35 percent) to the smallest of three amounts: the expense cap, California expenses, or California earned income. The state credit percentage is then applied. The state credit percentage varies from 34 to 50 percent based on the taxpayer’s AGI, and is limited to taxpayers with AGI of $100,000 or less.

Earned Income Tax Credit

Existing federal law allows eligible individuals a refundable Earned Income Tax Credit (EITC). A refundable credit allows the credit amount that exceeds 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.
State law provides a refundable California EITC that is generally patterned after the federal EITC as applicable for federal income tax purposes for the taxable year, except as modified. 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.

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. The California EITC includes in the definition of earned income net earnings from self-employment, consistent with federal law.¹

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, and before January 1, 2024, this bill, under the PITL, would allow a qualified taxpayer a TCTC in an amount equal to the difference between the qualified taxpayer’s net resources, as defined, and 50 percent of the poverty threshold for an identical size household in the county in which the qualified taxpayer resides using the California Poverty Measure.

This bill would define the following terms and phrases:

- “Adjustments to resources” means the sum of all of the following amounts paid or incurred by the qualified taxpayer during the taxable year.
  - Medical expenses.
  - Childcare expenses.
  - Commuting expenses and other nondiscretionary work-related expenses.

- “California Poverty Measure” means the poverty index produced jointly by the Public Policy Institute of California and the Stanford Center on Poverty and Inequality.

- “Childcare subsidies” includes payments or vouchers for childcare under the CalWORKS Child Care program or alternative payment childcare systems and the value of a contract paid on behalf of the qualified taxpayer to providers, including subsidies provided for general child care, state preschool, care for children with severe disabilities, and migrant childcare.

¹ Since taxable years beginning on or after January 1, 2017, earned income has included self-employment income, consistent with federal law.
• “Commuting expenses” means expenses for commuting to and from a place of employment.
• “Energy assistance” means assistance provided through the Low-Income Home Energy Assistance Program.
• “Gross resources” means the sum of all income derived by the qualified taxpayer during the taxable year from all of the following sources:
  o Seventy-five percent of income from wages and salaries.
  o Seventy-five percent of income from self-employment.
  o Interest and dividends.
  o Social security.
  o Unemployment insurance.
  o Pensions.
  o Alimony.
  o Veterans' benefits.
  o Child support payments.
  o CalWORKs cash benefits.
  o SSI/SSP payments.
  o General assistance payments made pursuant to Part 5 (commencing with Section 17000) of Division 9 of the Welfare and Institutions Code.
  o Benefits under CalFresh, the federal Supplemental Nutrition Assistance Program (Chapter 51 (commencing with Section 2011) of Title 7 of the United States Code), or the California Food Assistance Program (Chapter 10.1 (commencing with Section 18930) of Part 6 of Division 9 of the Welfare and Institutions Code).
  o School meal subsidies.
  o Housing subsidies.
  o Energy assistance.
  o Childcare subsidies.
• “Housing subsidies” means assistance under Section 8 of the United States Housing Act of 1937.
• “Medical expenses” means those expenses allowed as deductions under Section 213 of the Internal Revenue Code (IRC).
• “Net resources” means an amount that is equal to the difference between both of the following:
  o Gross resources.
  o Adjustments to resources.
“Qualified taxpayer” means a taxpayer who satisfies both of the following:

- Has at least one dependent who satisfies all of the following:
  - For the taxable year beginning on or after January 1, 2019, and before January 1, 2020, a dependent who is under three years of age.
  - For the taxable year beginning on or after January 1, 2020, and before January 1, 2021, a dependent who is under six years of age.
  - For the taxable year beginning on or after January 1, 2021, and before January 1, 2022, a dependent who is under 12 years of age.
  - For taxable years beginning on or after January 1, 2022, a dependent who is under 18 years of age.

- Has applied for all state and federally funded benefits to which the taxpayer is entitled to.

“School meal subsidies” means assistance under the federally funded National School Lunch Program and the School Breakfast Program.

If the TCTC allowed for the taxable year exceeds the tax liability for the taxable year, the excess would be credited against other amounts due, if any, and the balance, if any, upon appropriation by the Legislature, would be paid to the taxpayer. Payments would be made to the taxpayer in 12 monthly installments. The Franchise Tax Board (FTB) would be required to administer the monthly payments in the form and manner as determined by the FTB.

The state departments and agencies that serve those who qualify for the TCTC would be required to provide the FTB with information, in the form and manner as requested by the FTB, to assist the FTB in determining the qualified taxpayer’s gross resources.

This bill would allow the FTB, with the assistance of the state departments and agencies that serve those who qualify for the TCTC, to develop estimates for both of the following:

- Adjustments to resources.
- The income and in-kind benefits derived from the following sources:
  - General assistance payments specified in subparagraph (L) of paragraph (6) of subdivision (b).
  - CalFresh benefits specified in subparagraph (M) of paragraph (6) of subdivision (b).
  - School meal subsidies specified in subparagraph (N) of paragraph (6) of subdivision (b).
  - Housing subsidies specified in subparagraph (O) of paragraph (6) of subdivision (b).
Energy assistance specified in subparagraph (P) of paragraph (6) of subdivision (b).
Childcare subsidies specified in subparagraph (Q) of paragraph (6) of subdivision (b).

The above estimates authorized to be developed by this bill may be based on, including, but not limited to, the following:

- Median estimates for families in deep poverty based on a review of United States Census, United States Current Population Survey, the American Community Survey, or related governmental sources.
- Information from the qualified taxpayer’s tax return as to earned income, family size, number of children, age of children, and other relevant factors, upon which estimates may be calculated or derived.

This bill, for purposes of complying with Revenue and Taxation Code (R&TC) section 41,² would specify Legislative findings and declarations that the purpose of the TCTC is to reduce poverty by providing a refundable tax credit to California’s poorest families with children.

The FTB would be required to annually prepare a written report on the following:

- The number of tax returns claiming the credit.
- The number of individuals represented on tax returns claiming the credit.
- The average credit amount on tax returns claiming the credit.
- The distribution of credits by number of dependents and income ranges.
- Using data from tax returns claiming the credit, an estimate of the number of families who are lifted out of deep poverty by the credit. For the purposes of this report, a family is in “deep poverty” if the income of the family is less than 50 percent of the California Poverty Measure.

The FTB would be required to provide the written report to the Senate Committee on Budget and Fiscal Review, the Assembly Committee on Budget, the Senate and Assembly Committees on Appropriations, the Senate Committee on Governance and Finance, the Assembly Committee on Revenue and Taxation, and the Senate and Assembly Committees on Human Services. The report would be submitted in compliance with Government Code section 9795.

² Under R&TC section 41, legislation that would create a new tax credit is required to include specific goals, purposes, objectives, and performance measures to allow the Legislature to evaluate the effectiveness of the credit.
The TCTC would be repealed by its own terms on December 1, 2024.

**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.

Implementing this bill would require changes to existing tax forms and instructions, robust education and outreach, and substantial changes to information systems to limit improper payments.

This bill lacks administrative details necessary to implement the bill and determine its impacts to the department’s systems, forms, and processes. For example:

- What “state departments and agencies” would be required to provide FTB information or assistance in implementing this bill’s provisions?
- What “information” would “state departments and agencies” be required to provide to the FTB for determining “gross resources” and when would the information be required to be provided?
- When, how often, and by whom would the “California Poverty Measure” be made available to the FTB?
- Would the FTB be required to verify if any outstanding debts exist prior to any monthly payment or only at return filing?
- What debts, if any, would refunds of the TCTC be allowed to offset? For example, would offset be limited to state income tax? Would offset be allowed against any type of debt referred to FTB for collection?
- In what order should payments (i.e. wage withholding) and credits be applied when determining a taxpayer’s balance due or refund?

Gross resources is not a figure that appears on federal or state tax returns. Typically, credits involving areas for which the department lacks expertise are certified by another agency or agencies that possess the relevant expertise. The certification language would specify the responsibilities of both the certifying agency and the taxpayer. It is recommended that this bill be amended to include a certifying agency.

This bill would allow the FTB, with the assistance of certain state departments and agencies to estimate “adjustments to resources” and specified “income and in-kind benefits.” The FTB lacks expertise related to these resources, and it is unclear how these estimates would be used. For clarity and ease of administration, it is recommended that this bill be amended to provide for a certifying agency.
The department lacks the ability to determine if the taxpayer has applied for “all programs to which the taxpayer is entitled,” and lacks expertise to determine if the credit will lift the taxpayer out of “deep poverty.” Typically, credits involving areas for which the department lacks expertise are certified by another agency or agencies that possess the relevant expertise. For clarity and ease of administration, the bill should be amended to clarify the programs and include a certifying agency.

This bill uses terms and phrases that are undefined, i.e., “income from self-employment,” “childcare expenses,” “alternative payment childcare systems,” “value of a contract paid on behalf of the qualified taxpayer to providers,” “general childcare,” “state preschool,” “severe disabilities,” “migrant child care,” “social security,” “unemployment insurance,” “pensions,” “alimony,” “Veteran’s benefits,” “child support payments,” “CalWORKS cash benefits,” “SSI/SSP payments,” “dependent,” “all state and federally funded benefits,” “state departments and agencies that serve those who qualify for the TCTC,” and “information.” It is recommended that these terms and phrases be defined by reference to an existing statutory definition. For example, the term “dependent” could be defined by reference to R&TC section 17056. The absence of definitions to clarify these terms could lead to disputes with taxpayers and would complicate the administration of this bill. For clarity and ease of administration, it is recommended that the bill be amended.

This bill would define the phrase “Childcare subsidies” by using undefined terms and phrases. For consistency of terminology, it is recommended that the bill be amended.

The definition of “commuting and other nondiscretionary work-related expenses” is unclear and could be more broadly interpreted than the author intends. For example, the type of vehicle that may be used for commuting, whether a vehicle may be purchased, or the mode of transportation (walking, cycling, public transit, carpool, etc.) that would be eligible, and the beginning point of the commute. For clarity and ease of administration, the bill should be amended.

The definition of “medical expenses” would limit the expense to the amount allowed as a deduction under IRC section 213, rather than the total amount of medical expenses paid or incurred by the taxpayer. If this is inconsistent with the author’s intent the bill should be amended.

The defined phrase “qualified taxpayer” by using the phrase “all of the following” requires the dependent to meet multiple age requirements. It is recommended that the term “all” be replaced with “any.”

For clarity, and consistency with common usage within the PITL, it is recommended that the phrase “at the close of the taxable year” be inserted after the age of the dependent appears in the bill. For example, “under three years of age at the close of the taxable year”.

Page 8
This bill would require regular annual appropriations by the Legislature to pay for the refundable portion of this credit. If there are insufficient funds available to cover all of the refunds due and payable, the department would suspend payment until additional funds were appropriated unless directed otherwise. Interest would have to be paid to refund recipients for the period the refund was delayed. This delay would result in additional contacts to the department by refund recipients, which would likely increase departmental costs.

This bill would make the refund subject to annual appropriation, thereby making the refund provisions intermittently operative. Absent funding certainty, it is unclear how the department would effectively employ resources necessary to administer this credit.

To avoid delayed implementation it is recommend that the bill be amended to grant the FTB regulatory authority and a waiver from rulemaking procedures required under the Administrative Procedures Act (APA).³

**Legislative History**

Research of California legislative history found no legislation similar to the provisions of this bill.

**Other States' Information**

Review of Illinois, Massachusetts, Michigan, and Minnesota tax laws found no comparable tax credits. However, New York tax law offers the Empire State Child Credit that is equal to the greater of $100 per qualifying children or 33 percent of the 2017 federal Child Tax Credit amount, subject to AGI limitations. These states were selected and reviewed due to their similarities to California's economy, business entity types, and tax laws.

**Fiscal Impact**

The department’s costs to implement this bill have yet to be determined, but are anticipated to be significant. As the bill moves through the legislative process, costs will be identified.

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³ Government Code section 11340 et seq.
Economic Impact

Revenue Estimate

This bill would result in the following revenue loss:

Estimated Revenue Impact of AB 24 as Amended May 1, 2019
Assumed Enactment after June 30, 2019

($ in Millions)

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<th>Fiscal Year</th>
<th>Revenue</th>
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<tr>
<td>2019-2020</td>
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<tr>
<td>2020-2021</td>
<td>-$800</td>
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<td>2021-2022</td>
<td>-$1200</td>
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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

Data from the California Budget and Policy Center indicate that there are approximately 455,000 households in California with at least one child under 18 years of age that would qualify for this credit. The Public Policy Institute of California (PPIC) estimates that approximately 25 percent of California households in deep poverty have at least one child who is under three years of age, so about 115,000 families would be eligible in the first year of the program. The corresponding number of households with at least one dependent under six, twelve, and eighteen years of age are, respectively, 215,000, 345,000, and 455,000. It is assumed that 55 percent of eligible households will have applied for all of the required state and federal benefits and would file a tax return to claim the credit in taxable year 2019.

Using FTB data, net resources is calculated and compared to the 50 percent of the poverty thresholds for households of different sizes, using the methodology employed by the PPIC. This resulted in an estimated average credit of $5,000 per household, per year, to be paid in 12 monthly installments. Multiplying qualified households by the average credit per household, results in an estimated revenue loss of $310 million in the 2019 taxable year, increasing to $1.4 billion in 2023, as children of older ages are included in the definition of the qualifying taxpayer.

The tax year estimates are converted to fiscal year revenue estimates, rounded and shown in the above table.
Policy Concerns

The department is concerned that another refundable credit could increase the trend in refund fraud and identity theft. Historically, both the Internal Revenue Service and the FTB have experienced fraud and improper claims with refundable credits. These concerns are heightened because if a refund is determined to be fraudulent, the refund commonly cannot be recovered.

This payment structure for a refundable tax credit could result in the taxpayer becoming ineligible partially or totally for other public assistance programs which could negate the ability to lift these taxpayers out of deep poverty. Research should be conducted to validate whether this is an issue or not and if it is, if this can be overcome by obtaining a waiver from said assistance programs.

This bill could allow taxpayers in certain circumstances to claim multiple tax credits for the same dependent. For example, the taxpayer could claim the Child and Dependent Care Expenses Credit, the California EITC, and the TCTC proposed by this bill.

The credit would be allowed for dependents who reside either inside or outside California.

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