



## Bill Analysis

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Sponsor:

Bill Number: SB 1140

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Introduced February 19, 2020

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Related Bills: See Legislative  
History

## SUBJECT

Child Poverty Tax Credit

## SUMMARY

This bill, under the Personal Income Tax Law (PITL), would modify the existing Young Child Tax Credit (YCTC) and create an additional refundable Child Poverty Tax Credit (CPTC) for qualified taxpayers who have a qualifying child under the age of six. The credit amount would vary based on the county of residence; however, the maximum credit available would \$2,500 in any taxable year.

The Franchise Tax Board (FTB) would be required to report specified information regarding the CPTC in accordance with Section 41 of the Revenue and Taxation Code (R&TC).

## RECOMMENDATION

No position

## SUMMARY OF AMENDMENTS

None noted.

## REASON FOR THE BILL

The reason for this bill is to provide financial assistance to families with children under the age of six to reduce deep child poverty in California.

## ANALYSIS

For taxable years beginning on or after January 1, 2020, this bill, under the PITL, would create the refundable CPTC for a qualified taxpayer, as specified. The credit amount would be limited as follows:

- For qualified taxpayers residing in "Region 1" counties on the last day of the taxable year, as specified in the Welfare and Institutions Code (WIC)(see Appendix A for detail), the amount of the credit would be equal to \$2,940,

multiplied by the earned income tax credit adjustment factor for the taxable year as specified for Section 17052. The maximum credit would be limited to \$2,500 in any taxable year.

- For qualified taxpayers residing in "Region 2" counties on the last day of the taxable year, as specified in the WIC (see Appendix A for detail), the amount of the CPTC would be equal to \$2,353, multiplied by the earned income tax credit adjustment factor for the taxable year as specified for Section 17052. The maximum credit would be limited to \$2,000 in any taxable year.

The credit amount would be reduced by \$20 for every \$100 by which the qualified taxpayer's earned income exceeds the "deep poverty threshold amount." For purposes of the CPTC, the "deep poverty threshold amount" would be equal to the CalEITC "phaseout amount," as adjusted for inflation, applicable for an eligible individual with two or more qualifying children (PITL section 17052(b)(2)). The "deep poverty threshold amount" would be recomputed annually in the same manner as the income tax brackets under subdivision (h) of Section 17041.

For purposes of the CPTC, this bill would define the following terms:

- "Qualified taxpayer" means an eligible individual as defined under the federal EITC<sup>1</sup> except that the identification number as required under Section 32(m) of the Internal Revenue Code (IRC), could be either a federal Individual Taxpayer Identification Number (ITIN) or an Social Security Number (SSN) without regard to its being valid for employment,<sup>2</sup> and who has at least one qualifying child.
- "Qualifying child" means a qualifying child as defined under the federal EITC, except as follows:
  - Includes a qualifying child who is a noncitizen.
  - May have a federal ITIN or an SSN without regard to its being valid for employment.
  - The qualifying child must be younger than six years old as of the last day of the taxable year.

If the amount allowable as a credit under the YCTC or the CPTC exceeds the tax liability for the taxable year, the excess shall be credited against other amounts due, if any, and the balance, if any, would be paid from the Tax Relief and Refund Account and refunded to the qualified taxpayer.

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<sup>1</sup> As defined in Section 32 of the IRC as amended by Public Law 115-141.

<sup>2</sup> Pursuant to clause (II) (or that portion of clause (III) that relates to clause (II)) of section 205(c)(2)(B)(i) of the Social Security Act.

The CPTC and the YCTC would only be operative for taxable years for which resources are authorized in the annual Budget Act for the FTB to oversee and audit returns associated with the CalEITC.

The existing Section 41 reporting requirements for the YCTC would be expanded to require the same information for the CPTC. The FTB would be required to annually prepare a written report on the following:

- The number of tax returns claiming the credits.
- The number of qualifying children represented on tax returns claiming the credits.
- The average credit amount on tax returns claiming the credits.

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.

#### *Effective/Operative Date*

This bill would be effective January 1, 2021, and specifically operative for taxable years beginning on or after January 1, 2020, if resources are authorized in the annual Budget Act for the FTB to oversee and audit returns association with the CalEITC. The effective date is premised on enactment by September 30, 2020.

#### *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 SSN 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 does not contain a comparable Child Tax Credit. However, state law allows a dependent exemption credit that would include the taxpayer's "qualifying child" as defined under IRC section 152. Among other requirements, the child must be under the age of 19 at the close of the taxable year, or a student who is under the age of 24. The age limit does not apply if the child is permanently and totally disabled. For tax year 2019, the credit amount is \$378 for each dependent.

## 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 \$55,952. 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.

For 2019, the California EITC is generally available to households with AGI of \$30,000 or less.

### Young Child Tax Credit

For taxable years beginning on or after January 1, 2019, state law allows the refundable YCTC for a qualified taxpayer, as specified. The maximum credit is limited to \$1,000 per taxable year.

The credit amount is reduced by \$20 for every \$100 by which the qualified taxpayer's earned income exceeds the threshold amount, initially set at \$25,000. For taxable years after the minimum wage is set at \$15 per hour (pursuant to Labor Code section 1182.12), the threshold amount will be recomputed annually in the same manner as the income tax brackets under subdivision (h) of Section 17041.

For purposes of the YCTC, the following terms and phrases are defined:

- "Qualified taxpayer" means an eligible individual who has been allowed the California EITC under Section 17052, and has at least one qualifying child.
- "Qualifying child" has the same meaning as under the California EITC (Section 17052), except that the child must be younger than six years old as of the last day of the taxable year.

### *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 changes to information systems to limit improper payments.

A "qualifying taxpayer" for purposes of the CPTC would be defined, in part, by reference to an "eligible individual" under the federal EITC rather than the CalEITC. Thus, a "qualifying taxpayer" would not be required to live in California for more than half the year, but instead would qualify for the CPTC based on the qualified taxpayer's California county of residence on the last day of the taxable year. If this is inconsistent with the author's intent, it is recommended that the bill be amended.

Due to recent federal policy changes suspending the issuance of federal ITINs for certain nonresident alien dependents, a qualifying child who is a noncitizen and would otherwise meet the qualifications for the CPTC may be ineligible due to the lack of a federal ITIN. If this is contrary to the author's intent, the bill should be amended to allow alternative identification.

This bill would only allow the CPTC for those years for which resources are authorized in the annual Budget Act for the FTB to oversee and audit returns associated with the CalEITC. FTB processes returns from January through November which spans two fiscal year periods and resources would need to be authorized for the full period to allow for all returns to be processed that could claim this credit. For ease of administration, and to ensure a viable metric upon which the credit could be allowed or not, it is recommended that the bill be amended to eliminate the language in subdivision (c) or determine another metric to allow for a sunset of a credit in any desired year.

#### *Technical Considerations*

To clarify the refund provision in subdivision (g), it is recommended that the bill be amended to insert ",combined," after "(b)" and before "exceeds".

#### *Policy Concerns*

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, the YCTC, and the CPTC proposed by this bill.

The department is concerned that another refundable credit could increase the trend in refund fraud and identity theft. Historically, both the IRC 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 bill lacks a date by which the credit would become inoperative, commonly referred to as a "sunset date." Sunset dates generally are provided to allow periodic review of the effectiveness of the credit by the Legislature.

#### **LEGISLATIVE HISTORY**

AB 24 (Burke, 2019/2020), would have created the refundable Targeted Child Tax Credit. AB 24 failed to pass by the constitutional deadline.

AB 91 (Burke, Chapter 39, Statutes of 2019), among other changes, modified the California EITC and established the refundable YCTC.

#### **PROGRAM BACKGROUND**

None noted.

## **FISCAL IMPACT**

The department's costs to implement this bill have yet to be determined, but costs are anticipated to be significant. 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 SB 1140 as Introduced February 19, 2020  
Assumed Enactment after June 30, 2020

(\$ in Millions)

<b>Fiscal Year</b>	<b>Revenue</b>
2020-2021	-\$310
2021-2022	-\$300
2022-2023	-\$290

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 EITC micro-simulation model, it is estimated that creating the CPTC would result in a \$310 million revenue loss in the 2020 taxable year.

The tax year estimates are converted to fiscal year estimates, and then rounded to arrive at the amounts reflected in the above table.

## **LEGAL IMPACT**

None noted.

## **APPOINTMENTS**

None noted.

**SUPPORT/OPPOSITION**

None noted.

**ARGUMENTS**

To be determined.

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**Appendix A**

Explanation of Counties in WIC section 11452.018

<b><i>Region</i></b>	<b><i>Counties in Region</i></b>
<b>Region 1</b>	Alameda, Contra Costa, Los Angeles, Marin County, Monterey, Napa, Orange, San Diego, San Francisco, San Luis Obispo, San Mateo, Santa Barbara, Santa Clara, Santa Cruz, Solano, Sonoma, and Ventura.
<b>Region 2</b>	Alpine, Amador, Butte, Calaveras, Colusa, Del Norte, El Dorado, Fresno, Glenn, Humboldt, Imperial, Inyo, Kern, Kings, Lake, Lassen, Madera, Mariposa, Mendocino, Merced, Modoc, Mono, Nevada, Placer, Plumas, Riverside, Sacramento, San Benito, San Bernardino, San Joaquin, Shasta, Sierra, Siskiyou, Stanislaus, Sutter County, Tehama, Trinity, Tulare, Tuolumne, Yolo, and Yuba.