STATE OF CALIFORNIA
Franchise Tax Board

# Bill Analysis

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| Author: Committee on Budget | Sponsor: | Bill Number: SB 201 |
| | Related Bills: See Legislative History | Amended: June 25, 2022, and June 26, 2022 |

## SUBJECT

California Earned Income Tax Credit: Young Child Tax Credit: Foster Youth Tax Credit: Budget Trailer Bill

## SUMMARY

This bill would do the following:

*Provision No. 1 – California Earned Income Tax Credit (CalEITC)*

Section 1 of the bill would, under the Personal Income Tax Law (PITL), specify the CalEITC phaseout percentages as recalculated for taxable year 2022 would apply to taxable year 2023 and later.

*Provision No. 2 - Young Child Tax Credit (YCTC)*

Section 2 of the bill would, under the PITL, for taxable years beginning on or after January 1, 2022, modify the YCTC to expand the definition of a qualified taxpayer, provide for indexing of the YCTC and make other technical nonsubstantive changes.

*Provision No. 3 - Foster Youth Tax Credit (FYTC)*

Section 3 of the bill would, under the PITL, for taxable years beginning on or after January 1, 2022, establish the refundable FYTC.

Section 4 of the bill would, under the Revenue and Taxation Code (RTC), authorize the FTB to disclose return or return information to the State Department of Social Services (SDSS) for purposes of administering the FYTC.

Section 5 of the bill would, under the Welfare and Institutions Code (WIC), require the SDSS to provide the FTB with information necessary to verify foster care status for the sole purpose of determining eligibility for the FYTC.

## RECOMMENDATION

No position.

## SUMMARY OF AMENDMENTS

The June 25, 2022, amendments removed intent language relating to the Budget Act of 2021, and replaced it with the provisions discussed in this analysis.

The June 26, 2022, amendments made technical corrections.

This is the department's first analysis of the bill.

## REASON FOR THE BILL

The reason for this bill is to help reduce California poverty by expanding the YCTC and establishing the FYTC.

## ECONOMIC IMPACT

Summary Revenue Table (*$ in Millions*)

| Fiscal Year | 2021-2022 | 2022-2023 | 2023-2024 |
|---|---:|---:|---:|
| Provision No. 1 – CalEITC | N/A | N/A | N/A |
| Provision No. 2 – YCTC | -$60 | -$80 | -$100 |
| Provision No. 3 – FYTC | -$17 | -$17 | -$18 |

## ANALYSIS

### *Provision No. 1:*

### *California Earned Income Tax Credit (CalEITC) (Section 1)*

This provision of the bill would, under the PITL, for taxable years beginning on or after January 1, 2023, specify that the phaseout percentages as recalculated for taxable year 2022 would apply.

This provision would clarify the reference to the Labor Code to mean the year the minimum wage is $15 for employers with 26 or more employees.

*Effective/Operative Date*

This provision would be effective January 1, 2023, and specifically operative for taxable years beginning on or after January 1, 2023.

## ECONOMIC IMPACT

*Revenue Estimate*

The CalEITC provision as amended June 26, 2022, would not impact state income or franchise tax revenue.

## FISCAL IMPACT

This provision would not significantly impact the department's costs.

***Provision No. 2:***

***Young Child Tax Credit (YCTC) (Sections 2 and 6)***

For taxable years beginning on or after January 1, 2022, this provision of the bill would, under the PITL, expand the YCTC by modifying the definition of a "qualified taxpayer" to include individuals who meet all the following requirements:

- Have earned income, as defined under the CalEITC, of zero dollars or less,
- Whose net losses, if any, do not exceed $30,000 in the taxable year, and
- Whose wages, salaries, tips, and other employee compensation, if any, do not exceed $30,000 in the taxable year.

For each taxable year beginning on or after January 1, 2022, the $30,000 cap for net losses and wages, salaries, tips, and other employee compensation would be indexed for inflation in the same manner as the income tax brackets.

For taxable years beginning on or after January 1, 2022, this provision would provide for the maximum amount of the YCTC to be indexed for inflation.

This provision would, for taxable year 2022, require the $20 phaseout amount to be indexed for inflation in the same manner as the income tax brackets, with the resulting amounts rounded off to the nearest cent. In addition, the $20 phaseout amount indexed for taxable year 2022 would apply to taxable years 2023 and forward.

This provision would clarify that the threshold amount would be indexed for inflation for taxable years beginning after the taxable year in which the minimum wage is $15 per hour for employers with 26 or more employees.

This provision would make a technical correction to Section 41 reference by removing "of the RTC".

This bill (in Section 6) would further provide that the Legislature finds and declares that the YCTC serves the public purpose of providing financial support to Californians and does not constitute gifts of public funds.

*Effective/Operative Date*

This provision would be effective January 1, 2023, and specifically operative for taxable years beginning on or after January 1, 2022. The use of the taxable year 2022 indexed phaseout amount and the indexing of the threshold amount would be specifically operative for taxable years beginning on or after January 1, 2023.

## ECONOMIC IMPACT

*Revenue Estimate*

This provision would result in the following revenue loss:

Estimated Revenue Impact as Amended June 26, 2022
Assumed Enactment after June 30, 2022

($ in Millions)

| Fiscal Year | Revenue |
|---|---:|
| 2022-2023 | -$60 |
| 2023-2024 | -$80 |
| 2024-2025 | -$100 |

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 Franchise Tax Board's (FTB's) EITC micro-simulation model and Internal Revenue Service (IRS) data on their non-filer economic stimulus payment portal, it is estimated that expanding the YCTC to taxpayers without earned income would result in a revenue loss of approximately $60 million in the 2022 taxable year.

## FISCAL IMPACT

This provision would impact the department's systems, resulting in programming, processing, and form revisions as well as the need for taxpayer outreach. The department's costs to implement this provision are estimated to be $4.4 million for fiscal year 2022-2023, $1.3 million for fiscal year 2023-2024 and estimated on-going annual costs of $1.2 million for the following three fiscal years.

***Provision No. 3**:*

***Foster Youth Tax Credit (FYTC) (Sections 3, 4 and 5)***

For taxable years beginning on or after January 1, 2022, this provision of the bill would, under the PITL, create the refundable FYTC for a qualified taxpayer, as specified. The credit amount would be $1,176 multiplied by the earned income tax credit adjustment factor for the taxable year. For taxable years beginning on or after January 1, 2022, this bill would further provide for the amount of the FYTC to be indexed for inflation in the same manner as the income tax brackets.

The credit amount would be reduced by $20 for every $100 by which the qualified taxpayer's earned income exceeds the threshold amount of $25,000. This bill would, for taxable years beginning on or after January 1, 2022, require the $20 phaseout amount to be indexed for inflation in the same manner as the income tax brackets, with the resulting amounts rounded off to the nearest cent. In addition, the $20 phaseout amount indexed for taxable year 2022 would apply to taxable years 2023 and forward.

For taxable years after the minimum wage as defined by Section 1182.12 of the Labor Code is set at $15 per hour, the threshold amount would be recomputed annually in the same manner as the income tax brackets.

The FYTC 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 earned income tax credit allowed under the PITL Section 17052.

This provision would define the following terms and phrases:

- "Qualified taxpayer" means an individual who satisfies the following:
  - Has been allowed a tax credit under Section 17052 (CalEITC) for the taxable year.
  - Is 18 to 25 years of age, inclusive, as of the last day of the taxable year.
  - Was in foster care while 13 years of age or older in an AFDC-FC placement, including a tribally approved home, or Approved Relative Caregiver Funding Program eligible placement, by a Title IV-E agency, pursuant to a voluntary placement agreement or a juvenile court order.
- "Threshold amount" would be twenty-five thousand dollars ($25,000).

- "Title IV-E agency" means either of the following:
  - A county child welfare agency or probation department that administers foster care placements under Title IV-E of the federal Social Security Act.
  - An Indian tribe, tribal organization, or tribal consortium located in California or with lands that extend into the state that has an agreement with the State Department of Social Services to administer foster care placement under Title IV-E of the federal Social Security Act.

This provision would, under the WIC, and subject to federal approvals or waivers, require the SDSS to provide to the FTB data regarding a qualified taxpayer placed by a Title IV-E agency necessary to verify that an individual qualifies for the FYTC. The data provided would remain confidential and would be used only for purposes directly connected with the FYTC.

In the event federal approval or waivers are not provided, the FTB and the SDSS would be required to explore alternative methods to verify foster care status for individuals in a manner consistent with state and federal law.

The SDSS would be required to seek all appropriate federal waivers or approvals as necessary.

The FTB would be authorized to prescribe rules, guidelines, procedures, or other guidance to carry out the purposes of the FYTC.

The FTB could also prescribe any regulations necessary or appropriate to administer the FYTC, including any regulations to prevent improper claims from being filed or improper payments from being made with respect to net earnings from self-employment. Any regulation, guideline, or procedure prescribed by the FTB would be exempt from the Administrative Procedure Act.

The FYTC is a refundable credit, the excess of the credit over the taxpayer's tax liability would be refunded to the taxpayer, after any applicable offsets.

Amounts refunded pursuant to this section would be treated in the same manner as the federal earned income refund for the purpose of determining eligibility to receive benefits under Division 9 of the WIC or amounts of those benefits.

The FYTC amount refunded would not be taken into account as income and would not be taken into account as resources for a period of 12 months from receipt, for purposes of determining the eligibility of qualified taxpayer, or any other individual, for benefits or assistance or the amount or extent of benefits or assistance under any state or local program. With respect to a state or local program, this provision will only be implemented to the extent that it does not conflict with federal law relating to that program, and that any required federal approval or waiver is first obtained for that program.

This provision states that the Legislature finds and declares that qualified undocumented persons are eligible for the FYTC.

This provision would specify that for purposes of RTC section 41, the purpose of the FYTC is to reduce poverty among California's young adults who have been in the foster care program. To measure whether the credit achieves its intended purpose, the FTB would be required to annually prepare a written report on the following:

- The number of tax returns claiming the credit.
- The average credit amount on tax returns claiming the credit.

The FTB would be required to provide the written report to specified Senate and Assembly committees. The disclosure provisions would be treated as an exception to the general prohibition against disclosure applicable to FTB.

Section 4 of the bill would, under the RTC, authorize the FTB to disclose to the SDSS return or return information, limited to information necessary to verify eligibility, including, but not limited to, earnings, identifying information, or other information needed for administration of the FYTC, through information sharing agreements or data interfaces. The information provided to the SDSS under this section would be subject to Section 19542.

The SDSS and any officer, employee, or agent, or former officer, employee, or agent, of the SDSS cannot disclose or use any information obtained from the FTB except for the purpose of administration of the FYTC.

In addition, Section 5 of the bill would, under the WIC, provide the SDSS would be required to provide the FTB with information necessary to verify foster care status for the sole purpose of determining eligibility for the FYTC. The SDSS would be required to seek any federal approval necessary to implement this requirement. These provisions would be operative only to the extent permitted by federal law.

*Effective/Operative Date*

This provision would be effective January 1, 2023, and specifically operative for taxable years beginning on or after January 1, 2022, contingent upon the annual Budget Act authorizing resources to the FTB for administration of the CalEITC. The use of the taxable year 2022 indexed phaseout amount and the indexing of the threshold amount would be specifically operative for taxable years beginning on or after January 1, 2023.

## ECONOMIC IMPACT

*Revenue Estimate*

This provision would result in the following revenue loss:

Estimated Revenue Impact as Amended June 26, 2022
As enacted June 30, 2022

($ in Millions)

| Fiscal Year | Revenue |
|---|---:|
| 2022-2023 | -$17 |
| 2023-2024 | -$17 |
| 2024-2025 | -$18 |

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 data from the SDSS, there are approximately 75,000 qualified taxpayers between the ages of 18 to 25 who were in foster care while 13 years of age or older. Based on foster youth income and employment research, it is estimated that approximately 30,000, or 40 percent, would qualify for CalEITC, and 17,000, or 60 percent, would earn enough income to file a tax return.  Applying an average credit of $1,000 would result in an estimated revenue loss $17 million in the 2022 taxable year.

## FISCAL IMPACT

This provision would impact the department’s systems, resulting in programming, processing, and form revisions as well as the need for taxpayer outreach.  The department’s costs to implement all sections of this provision are estimated to be $2.9 million for fiscal year 2022-2023 and $280,000 for fiscal year 2023-2024 and on-going.

## Federal/State Law (All Provisions)

*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 2021, the EITC is available to individuals and families earning up to $57,414. The federal credit rate varies from 7.65 percent to 45 percent, depending on the number of qualifying children.

An eligible individual 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:
- Has attained the age of 25 but not 65 before the close of the taxable year.
- Has 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 be a U.S. citizen or resident alien. If the eligible individual or spouse were a nonresident alien for any part of the tax year, the qualified individual can only claim the EITC if their filing status is married filing jointly and the individual or spouse is a:

- U.S. Citizen with a valid Social Security number (SSN), or
- Resident alien who was in the U.S. at least 6 months of the year and has a valid Social Security number.

Certain individuals are specifically excluded from the definition of an eligible individual. For example, a qualifying child, an individual who claims benefits relating to citizens or residents living abroad, a nonresident alien not treated as a U.S. resident for tax purposes.

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*

State law provides a refundable CalEITC that is generally determined in accordance with IRC section 32, as applicable for federal income tax purposes for the taxable year, except as modified.

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, and for taxable years beginning on or after January 1, 2018, may have reached the age of 18 by the close of the taxable year (rather than have attained the age of 25 but not attained the age of 65 before the close 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.

State law conformed to the federal requirement that an eligible individual and any qualifying child must have a valid SSN. Starting in taxable years beginning on or after January 1, 2020, CalEITC eligibility is extended to individual with a taxpayer identification number (ITIN).

For purposes of the CalEITC, the federal definition of "earned income" is modified to include wages, salaries, tips, and other employee compensation, includable in federal gross income, but only if such amounts are subject to California withholding.

For 2021, the CalEITC is generally available to taxpayers with earned income of $30,000 or less.

Starting in 2019, a taxpayer who has been allowed the CalEITC and who has a qualifying child younger than six years old as of the last day of the taxable year may qualify for the YCTC. 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 as defined by Section 1182.12 of the Labor Code is set at $15 per hour, the threshold amount will be recomputed annually in the same manner as the income tax brackets.

The YCTC includes the following terms and phrases:

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

*Implementation Considerations* (*All Provisions*)

None noted.

*Technical Considerations* (*All Provisions*)

None noted.

*Policy Considerations* (*All Provisions*)

None noted.

## LEGISLATIVE HISTORY (*All Provisions*)

AB 1766 (Stone, et al., Chapter 482, Statutes of 2022) would, amend the Vehicle Code to require the issuance of an identification card, as specified. Additionally, under the PITL, this bill would allow the FTB to request the taxpayer to provide identifying documents acceptable for purposes of obtaining the identification card to substantiate the California Earned Income Tax Credit (CalEITC).

AB 2589 (Santiago, et al, 2021/2022) would, under the PITL, establish a minimum CalEITC, subject to appropriation; specify the CalEITC phaseout percentages as recalculated for taxable year 2022 would apply to taxable year 2023 and later; modify the YCTC to allow an alternative computation, including expanded definitions of qualified taxpayer and qualifying child. AB 2589 did not pass out of the Senate by the constitutional deadline.

SB 860 (Rubio and Hueso, 2021/2022) would, under the PITL, expand the eligibility of the YCTC to individuals with zero earned income or less but, require the indexing of the credit starting with taxable year 2022, require the indexing of the $20 phaseout amount for taxable year 2022 only, add additional reporting requirements for the FTB. SB 860 did not pass out of the Assembly by the constitutional deadline.

AB 1876 (Committee on Budget, Chapter 87, Statutes of 2020) modified the CalEITC by allowing the use of federal ITINs for all eligible individuals, eligible individuals' spouses, and qualifying children.

AB 91 (Burke, et al., Chapter 39, Statutes of 2019) enacted the California YCTC and made a number of changes conforming to Federal law.

SB 855 (Committee on Budget and Fiscal Review, Chapter 52, Statutes of 2018) expanded the CalEITC qualifying income range and revised the age range for eligible individuals.

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 CalEITC 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.

AB 1942 (Santiago, 2017/2018), would have required the FTB to modify the Form 540 related to the CalEITC, and modify *The EITC Information Act*. AB 1942 was held in the Assembly Appropriations Committee.

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

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

## PROGRAM BACKGROUND

None noted.

## LEGAL IMPACT

None noted.

## APPOINTMENTS

None noted.

## SUPPORT/OPPOSITION

None on file.

## ARGUMENTS

None on file.

## LEGISLATIVE CONTACT

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