STATE OF CALIFORNIA
Franchise Tax Board

Bill Analysis

Author: Gipson

Sponsor:

Bill Number: AB 1498

Related Bills: See Legislative History

Introduced: February 17, 2023

SUBJECT

California Earned Income Tax Credit and Young Child Tax Credit: Offsets

SUMMARY

This bill would, under the Government Code (GOV), specify that the Controller cannot offset delinquent accounts against personal income tax refunds of an individual who received advance or periodic payments of the California Earned Income Tax Credit (CalEITC) or the Young Child Tax Credit (YCTC).

This bill would, under the Personal Income Tax Law (PITL), establish a minimum CalEITC, subject to appropriation, and would provide for the indexing of the minimum credit amount, and would provide for a phaseout of the minimum credit.

RECOMMENDATION

No position.

SUMMARY OF AMENDMENTS

Not applicable.

REASON FOR THE BILL

The reason for this bill is to establish a minimum CalEITC.

ANALYSIS

This bill would, under the GOV, for taxable years beginning on or after January 1, 2024, specify that the Controller cannot offset delinquent accounts against advance or periodic payments of the CalEITC or the YCTC.

Subject to an appropriation by the Legislature, this bill would also make modifications to the CalEITC related to a minimum credit amount. Specifically, this bill would, under the PITL, for taxable years beginning on or after January 1, 2023, modify the CalEITC by establishing a minimum credit amount. To accomplish the minimum credit, this bill would provide that if the amount of the CalEITC for an eligible individual is less than

$355, multiplied by the earned income tax credit adjustment factor for that taxable year, the credit for the eligible individual would be $355, multiplied by the earned income tax credit adjustment factor for the taxable year.

This bill would, for taxable years beginning on or after January 1, 2024, require the minimum credit amount to be indexed for inflation.

Additionally, this bill would specify that the minimum credit amount would be reduced by $5 for each $100, or fraction thereof, by which the qualified taxpayer's adjusted gross income or, if greater, earned income, exceeds the threshold amount. For purposes of this computation, the threshold amount would be $28,000. As proposed in this bill, the minimum credit amount would extend the phase out range beyond the current earned income limit.

For taxable years beginning after the taxable year in which the minimum wage is set at $15 per hour, the threshold amount would be recomputed annually in the same manner as the recomputation of income tax brackets under Revenue and Taxation Code (RTC) section 17041(h).

Effective/Operative Date

If enacted, this bill would be effective on January 1, 2024. The offset provision would be operative for taxable years beginning on or after January 1, 2024. Upon appropriation by the legislature, the CalEITC provisions would be specifically operative at different times. The minimum credit amount would be specifically operative for taxable years beginning on or after January 1, 2023. The indexing of the minimum credit amount would be specifically operative for taxable years beginning on or after January 1, 2024. The indexing of the phase out of the minimum credit amount would be specifically operative for taxable years beginning after the minimum wage is set to $15 per hour, which occurred on January 1, 2022.

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 2022, the EITC is available to individuals and families earning up to $59,187. The federal credit rate varies from 7.65 % to 45%, 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

<u>CalEITC</u>

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 2022, the CalEITC is generally available to taxpayers with earned income of $30,000 or less.

YCTC

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.

<u>Offsets – CalEITC and YCTC</u>

State law, under the GOV, specifies that, for taxable years beginning on or after January 1, 2024, the Controller cannot offset delinquent accounts against the personal income tax refunds of an individual who received the CalEITC or the YCTC for the taxable year. This provision does not apply to delinquent accounts for the nonpayment of child or family support.

Implementation Considerations

The department has identified the following implementation consideration and is available to work with the author's office to resolve this and other considerations that may be identified.

This bill suggests a one-time appropriation by the Legislature for the minimum CalEITC provision to become operative. The timing of the one-time appropriation is unknown yet is necessary for each year the statute is operative. If the minimum CalEITC provision becomes operative, it would be operative indefinitely, but no funding would be appropriated. If this is contrary to the author's intent, the author may wish to amend the bill to ensure an annual appropriation is made.

Technical Considerations

In paragraph (1) of subdivision (s) of Section 17052, consider replacing "For taxable years beginning on or after January 1, 2023, if the amount of credit computed pursuant to subdivision (a), (b), or (o)" with " For taxable years beginning on or after January 1, 2023, if the amount of credit computed pursuant to subdivision (a) and (b), or (o)".

Policy Considerations

This bill would result in an increase to the maximum earned income where the minimum CalEITC would be completely phased out resulting in inconsistent treatment with the phaseout of the regular CalEITC. Using the phase out of $5 for every $100, the $355 minimum CalEITC would extend the phase out range beyond the current earned income limit. The author should amend this bill to clarify the desired outcome.

This bill would specify that the Controller cannot offset delinquent accounts against personal income tax refunds of an individual who received advance or periodic payments of the CalEITC or the YCTC. If it is the intent of the author to also include the Foster Youth Tax Credit (FYTC) here, the author may wish to amend the bill to clarify.

LEGISLATIVE HISTORY

AB 441 (Haney, 2023/2024) would, under the PITL, require the Franchise Tax Board (FTB) to establish a program for making advance periodic payments to qualified taxpayers allowed the CalEITC, the YCTC, and the FYTC. AB 441 is currently in the legislative process.

AB 1128 (Santiago, et al., 2023/2024) would, under the PITL, expand the eligibility of the YCTC by changing the definition of a qualifying child to have the same meaning as under the CalEITC. AB 1128 is currently in the legislative process.

AB 194 (Committee on Budget, Chapter 55, Statutes of 2022) Section 1 of the bill, under the GOV, for taxable years beginning on or after January 1, 2024, provides that the Controller cannot offset delinquent accounts against personal income tax refunds of an individual who received the CalEITC or the YCTC.

SB 201 (Committee on Budget, Chapter 72, Statutes of 2022) Section 2 of the bill, under the PITL, for taxable years beginning on or after January 1, 2022, modified the YCTC to expand the definition of a qualified taxpayer, provide for indexing of the YCTC, enacted the FYTC and made other technical nonsubstantive changes.

AB 2589 (Santiago, et al, 2021/2022) would have, under the PITL, established a minimum CalEITC, subject to appropriation; specified the CalEITC phaseout percentages as recalculated for taxable year 2022 would apply to taxable year 2023 and later; modified 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 have, under the PITL, expanded 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, required the indexing of the $20 phaseout amount for taxable year 2022 only, added 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 several 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 Annual Gross Income 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 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.

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 resources will be requested, if necessary.

ECONOMIC IMPACT

Revenue Estimate

Offsets - Advance or periodic payments of the CalEITC or the YCTC

This provision as introduced February 17, 2023, does not change the way income or franchise tax is calculated under the RTC.

Minimum CalEITC Calculation

This provision would result in the following revenue loss:

Estimated Revenue Impact of AB 1498 as Introduced February 17, 2023
Assumed Enactment after June 30, 2023

($ in Millions)

Fiscal Year	Revenue
2023-2024	-$850
2024-2025	-$900
2025-2026	-$950

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 EITC micro-simulation model, it is estimated that changing the CalEITC credit calculation would result in an additional revenue loss of approximately $850 million in the 2023 taxable year. To arrive at this amount, the estimated threshold amount used in the model was extended to $29,484, and the point where the credit amount would be fully phased out to zero was estimated to be $35,524. However, these amounts would change once the California Department of Industrial Relations updates the California Consumer Price Index rates and are indexed annually for inflation.

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

None noted.

LEGISLATIVE CONTACT

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