STATE OF CALIFORNIA
Franchise Tax Board

Bill Analysis

Author: Haney

Sponsor:

Bill Number: AB 441

Related Bills: See Legislative History

Amended: March 9, and March 29, 2023

SUBJECT

Advanced, Periodic Payments: Earned Income Tax Credit, Young Child Tax Credit, and Foster Youth Tax Credit

SUMMARY

This bill would, under the Personal Income Tax Law (PITL), require the Franchise Tax Board (FTB) to establish a program for making advance periodic payments to qualified taxpayers allowed the California Earned Income Tax Credit (CalEITC), the Young Child Tax Credit (YCTC), and the Foster Youth Tax Credit (FYTC).

RECOMMENDATION

No position.

SUMMARY OF AMENDMENTS

The March 9, 2023, amendments added a requirement for the FTB to establish a periodic payment program for the CalEITC, the YCTC, and the FYTC, defined new terms, and amended the computation of the allowable amount of the CalEITC, the YCTC, and the FYTC by the amount received through periodic payments.

The March 29, 2023, amendments removed method of distribution of periodic payments, added a provision requiring the FTB to determine the aggregate amount allowed to a taxpayer under the CalEITC, YCTC, and FYTC for the taxable year, added a $300 threshold for repayment of excess advance periodic payments, and would make the operative date contingent upon FTB obtaining a federal waiver. This bill would require the FTB to work in coordination with State Department of Public Health, the State Department of Social Services, and any other relevant state agency, to request the federal waiver.

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

REASON FOR THE BILL

The reason for this bill is to allow the FTB to distribute advance periodic payments of the CalEITC, YCTC and the FYTC.

ANALYSIS

This bill would, under the PITL, require the FTB to establish a program for making periodic payments to qualified taxpayers allowed the CalEITC, the YCTC and the FYTC. The combined total of all periodic payments made to a qualified taxpayer during any calendar year would be equal to the annual advance amount determined with respect to that taxpayer.

The FTB could modify the annual advance amount with respect to a qualified taxpayer for a calendar year to take into account information made available to the FTB that may lead to a change in the annual advance amount, including, but not limited to, a tax return filed by the qualified taxpayer. In the case of any modification of the annual advance amount, the FTB could adjust the amount of any periodic payment made after the date of the modification to properly adjust the amount by which any prior periodic payments were greater than or less than the amount the payment would have been based on the modified annual advance amount.

This bill would define the following terms:

“Annual advance amount” means, with respect to a qualified taxpayer for any calendar year, the amount, if any, that the FTB estimates is equal to 80 percent of the aggregate amount allowed of the CalEITC, the YCTC and the FYTC for the qualified taxpayer’s taxable year that begins in that calendar year.

“Qualified taxpayer” means an eligible individual, as that term is defined in Section 17052, or a qualified taxpayer as that term is defined in either Section 17052.1 or 17052.2. A “qualified taxpayer” would not include a taxpayer if the combined total amount allowed of the CalEITC, the YCTC and the FYTC is less than $1,000 for the applicable taxable year.

This bill would require the FTB to:

> Upon receiving a tax return from a qualified taxpayer, determine the aggregate amount allowed to a taxpayer as a credit under Sections 17052, 17052.1, and17052.2 for the taxable year.
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> Allow a qualified taxpayer, through its internet website, to report changes to their income, household size, filing status, or any other personal information that the FTB deems relevant to the calculation of the annual advance amount.
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> Send at least two annual reminders to people likely to be qualified taxpayers to record any changes to relevant personal information.

This bill would provide that if the advance monthly payments made to a qualified taxpayer exceeds the aggregate amount allowed by more than $300, the qualified taxpayer would be liable to repay the portion of the difference that is in excess of $300 within three taxable years after receiving notice from the FTB of the excess payment. If the excess payment to a qualified taxpayer is less than $300, the taxpayer shall not be liable to repay that amount.

This bill would allow tax filers to decline participation in periodic payments at any time through the FTB's internet website.

The bill would allow the FTB to prescribe any regulations necessary or appropriate to carry out the purposes of this bill, including any regulations to prevent improper claims from being filed or improper payments from being made.

The bill would also allow the FTB to prescribe rules, guidelines, procedures, or other guidance to administer periodic payments. The Administrative Procedures Act would not apply to any rule, guideline, or procedure prescribed by the FTB.

Notwithstanding any other law, amounts distributed pursuant to this bill would be treated in the same manner as the federal earned income refund for the purpose of determining eligibility to receive social welfare benefits or amounts of those benefits.

This bill would require the State Controller to transfer, as needed, to the Tax Relief and Refund Account, from the Personal Income Tax Fund, an amount necessary to make the estimated payments.

This bill would require the FTB, in coordination with the State Department of Public Health, the State Department of Social Services, and any other relevant state agency, to request a waiver from any federal agency that administers benefits, for which eligibility, or calculation of which, is based on a recipient's monthly income, to exclude from income any amount paid in monthly advance payments authorized in this bill for purposes of determining eligibility for, or calculation of benefits under, those programs. This bill would be operative contingent upon obtaining federal waivers, as specified.

This bill would modify the computation of the CalEITC, the YCTC and the FYTC by requiring that the allowed credit amount be reduced, but not below $0, by any amount received by the eligible individual or qualified taxpayer, as applicable, pursuant to Section 17052.3 that relates to an estimated allowance of the CalEITC, YCTC, or FYTC.

Effective/Operative Date

This bill would be effective January 1, 2024, and specifically operative for the taxable years beginning on or after January 1 of the year that includes either the date that federal legislation is enacted or regulations, guidelines, memoranda, or letters are published to a state agency official by any relevant federal agency, declaring that periodic payments are excluded from income for the purpose of determining eligibility for or the calculation of any benefits under an enumerated federal public assistance programs.

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 under $ 59,187. 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

<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 tax year 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.

In addition, for taxable years beginning on or after January 1, 2022, the YCTC is also allowed to an eligible individual with a qualifying child under six years old who meets all of the following requirements:

- Would otherwise have been allowed a tax credit under Section 17052, but has earned income, as defined, of zero dollars ($0) or less.
- Does not have net losses in excess of $30,000 in the taxable year.
- Does not have wages, salaries, tips, and other employee compensation in excess of $30,000 in the taxable year.

FYTC

Starting in tax year 2022, a taxpayer who has been allowed the CalEITC, is 18 to 25 years of age, inclusive, as of the last day of the taxable year and is a foster youth, as defined, may qualify for the FYTC. 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.

Implementation Considerations

The FTB has identified several implementation considerations for this bill, some of which are discussed below.

This bill would require the FTB to estimate the annual advance amount. FTB does not have relevant data to determine a credit amount to determine an advance or to validate an application if the taxpayer were to present one to request an advance payment. Historical program statistics show that only around 50% of taxpayers who are allowed the YCTC in any year will apply for the credit in the next year. For CalEITC, historical program stats show that around 60% of taxpayers who are allowed the CalEITC will apply for the credit in the next year. Income, filing status, and family dynamics can quickly change further reducing the ability to accurately estimate an advance payment. Any estimate the FTB makes relying on prior year filings, will be substantially incorrect resulting in overstated advance payments being made.

The FTB would require significant lead time to "stand up" an advance periodic payment program. Such a program would require the establishment of a new program and system changes to process periodic payments and to support program administration. All aspects of implementation, administration including systems changes, taxpayer education and outreach; and the hiring and training of new staff could not begin until after the enactment of this bill and the receipt of waivers from various federal agencies declaring that periodic payments are excluded from income for the purpose of determining eligibility for or the calculation of any benefits under enumerated federal public assistance programs. The author may wish to consider adding language to clarify that additional time is needed for program implementation which could span several years due to the magnitude of changes needed.

This bill would make the periodic payments provision contingent upon federal legislation, regulations, guidelines, memoranda, or a letter that sets forth that the periodic payments would be excluded from the definition of income for the eligibility determination for certain federal programs. Paragraphs (1) and (2) of subdivision (j) of section 17052.3, provide, "… shall be excluded from the definition of income for the purpose of determining eligibility for, or calculation of benefits under, any federal public assistance program, eligibility for which is dependent upon a recipient's monthly income…". The language is unclear as to whether the federal determination would need to apply to "any" program, meaning that the exemption must be a global exclusion or whether the operative language is triggered if there is a federal determination of exclusion for "any of" the programs, so if there is an exclusion determination only for Medicaid, for example, the entire periodic payment becomes operative. Depending on the author's intent, this would have significant impacts as to when the program starts.

The FTB does not have infrastructure in place to engage in an advance payment concept, like periodic payments, and IT costs to implement such an infrastructure will be substantial and likely be in the tens of millions of dollars. Business staffing costs will depend on the expected volume of eligible individuals and whether those individuals can request advanced payments at any time or only with the tax return.

The bill requires a comparison of the advance payment to the credit allowed but does not specifically require the filing of a tax return to do so. The author should consider amending the bill to clarify a return is required to be filed to reconcile the advance payment to the credit allowed.

This bill allows for a special three-year collection period for the recovery of an advance payments which is in conflict with current statutes and practices and will require substantial modifications to existing systems. This bill is also unclear whether the taxpayer would qualify for another advance payment for the next year, if an advance payment was previously overstated, is subject to collection, and remains an outstanding debt. Statutes and practices today allow for FTB to reduce income tax refund balances due for other state income tax debts owed by the taxpayer. The author should consider amending this and other statutes as necessary to provide clarity.

Additional program details are necessary to implement the program for advance payments specified in the bill and to determine the impact to the department's systems, processes, and forms. For example, clarification is needed on the following issues:

> How a qualified taxpayer will request an advance payment. For example, requests for participation in the advance payment program could be made on the department's website or on the tax return being filed, within a specific period of time. Further, it is not clear whether a qualified taxpayer would be required to request advance payment each year or be allowed to participate for successive years without applying each year.
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> The bill is silent regarding the timing of modifications allowed. The bill would allow the FTB to modify the annual advance amount. However, the timing of those modifications is not clear.
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> It is not clear if all qualified taxpayers would automatically be included in the periodic payment program unless they specifically decline participation.
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> This bill is silent with regards to the treatment of a qualified taxpayer that files a joint return with their spouse. The author may wish to amend the bill to specify that a qualified taxpayer that files a joint return with their spouse would be considered one qualified taxpayer and would receive only one periodic payment amount.

This bill includes the undefined terms "estimated allowance", "periodic payments", "tax filers", "modified annual advance amount", and "estimated payments." For clarity to the taxpayers and FTB, the bill should be amended to define these terms.

Technical Considerations

This bill would modify the computation of the CalEITC, the YCTC and the FYTC by requiring that the allowed credit amount be reduced, but not below zero dollars, by any amount received by the eligible individual pursuant to Section 17052.3 that relates to an estimated allowance. Rather than modifying the computation of each of these credits, the author should consider amending Section 17052.3 of the bill to clarify a return is required to be filed to reconcile the advance payment to the credit allowed, as noted above.

This bill uses the following words interchangeably: periodic payments, estimated payments, estimated allowance, advance monthly payments and monthly advance payments; qualified taxpayer and tax filers; and calendar year and taxable year. For consistency, it is recommended that the bill be amended or that these terms be defined.

Policy Considerations

This bill would provide that if the advance monthly payments made to a qualified taxpayer exceeds the aggregate amount allowed by less than $300, the taxpayer would not be liable to repay that amount. This could be determined to be a gift of public funds.

Generally, if a debt owed by a taxpayer is canceled or forgiven, other than as a gift or bequest, the taxpayer must include the canceled amount in both federal and state income. There are certain exceptions to this, such as when a taxpayer is insolvent.

LEGISLATIVE HISTORY

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 1498 (Gipson, 2023/2024) would, under the 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 among other provisions. AB 1498 is currently in the legislative process.

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, provided 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.

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., 2019/2020, 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.

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.

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

Department staff is unable to determine the costs to administer this bill until the implementation considerations are resolved but anticipates the costs to be significant.

Significant and extensive program development and system modifications are necessary to support this program and will likely take several years to implement. As the bill moves through the legislative process, a costing analysis will be performed. An analysis as to when this can be effectively implemented can also occur during this costing exercise but is also dependent on other legislative priorities enacted as well.

ECONOMIC IMPACT

Revenue Estimate

The bill would have a significant revenue loss that would likely exceed $100 million. However, the amount of loss cannot be determined until the implementation considerations discussed above have been addressed.

LEGAL IMPACT

None noted.

APPOINTMENTS

None noted.

SUPPORT/OPPOSITION

None on file.

ARGUMENTS

None on file.

LEGISLATIVE CONTACT

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