



Bill Analysis

Author: Caballero and Irwin

Sponsor:

Bill Number: SB 565

Related Bills: See Legislative
History

Introduced February 15, 2023,
and Amended March 21, 2023,
March 22, 2023, and
April 18, 2023.

SUBJECT

EITC, YCTC, and FYTC Free Tax Return Preparation Program

SUMMARY

This bill would, under the Administration of Franchise and Income Tax Law (AFITL), allow the Franchise Tax Board (FTB) to exchange data with the California Department of Social Services (DSS) and the Department of Health Care Services (DHCS) for purposes of administering the free tax return preparation program that would be established by this bill.

This bill would, under the AFITL, require the FTB to provide a free tax return preparation program to individuals eligible for the California Earned Income Tax Credit (CalEITC), the Young Child Tax Credit (YCTC), and the Foster Youth Tax Credit (FYTC). The program would utilize prepopulated data and would allow taxpayers to edit or correct information before filing their California personal income tax return. The bill would allow the FTB the option to use CalFile for this program.

RECOMMENDATION

No position.

SUMMARY OF AMENDMENTS

The March 21, 2023, amendments removed language relating to the Earned Income Tax Credit Information Act and replaced it with the provisions discussed in this analysis.

The March 22, 2023, amendments removed the provision that would have allowed a qualified individual to claim a qualified credit on a form without filing an individual income tax return.

The April 18, 2023, amendments modified the definitions of a "qualified individual" and "free tax return preparation program", updated the requirements of the free tax return preparation program, changed the date the program would be available, added a principal coauthor, and made other nonsubstantive changes.

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

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REASON FOR THE BILL

This bill is intended to provide a free electronic filing program with prepopulated data and increase outreach for the CalEITC, the YCTC, and the FYTC.

ANALYSIS

This bill would, under the AFITL, expand the existing data sharing provision between the DSS, the DHCS, and the FTB, to allow for the exchange of data directly connected with the administration of the free tax return preparation program established under Section 19587 that would be added by this bill. Data that may be exchanged would include, but not be limited to, names, addresses, and contact information of individuals that may qualify for the program.

This bill would, under the AFITL, for taxable years beginning on or after January 1, 2025, require the FTB to provide a free tax return preparation program to qualified individuals.

The program would initially be available, for taxable years beginning on or after January 1, 2025, and before January 1, 2027, to a qualified individual who is an individual with no dependents or who is a spouse filing a separate return with no dependents. For taxable years beginning on or after January 1, 2027, the program would be available to all qualified individuals.

This bill would define the following terms:

“CalFile” means the FTB’s free, direct, online program for taxpayers to complete and e-file their California personal income tax returns.

“Free tax return preparation program” means a free program that utilizes the prepopulation of data, to the extent possible, for qualified individuals to complete and e-file their California personal income tax returns.

“Qualified individual” means an individual, as defined by Section 17005, that meets all of the following:

- Has filed an individual income tax return for at least one of the five taxable years prior to the calendar year that the individual attempts to use the free tax return preparation program.
- Received an invitation from the FTB to participate in the free tax return preparation program for the taxable year.
- Is eligible to use CalFile for the taxable year.
- Is eligible for the CalEITC, the YCTC, or the FYTC.

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The free tax return preparation program would meet the following requirements:

- Provide questions to guide qualified individuals to file their California income tax return.
- Allow taxpayers to edit or correct information on their return prior to filing, including filing status and information on dependents.

The FTB may utilize CalFile as the free tax return preparation program, if CalFile meets the requirements of this bill.

The free tax return preparation program would be available beginning on January 20, 2026.

The FTB would be exempt from all provisions of state contracting laws and from Project Approval Lifecycle requirements and reporting, including Stage Gates 1-4, Financial Analysis Worksheets, Project Status Reports, and Post Implementation Evaluation Reports, as provided, for purposes of developing the free tax return preparation program.

Effective/Operative Date

This bill would be effective January 1, 2024, and specifically operative for taxable years beginning on or after January 1, 2025, for a qualified individual who is an individual with no dependents or who is a spouse filing separate return with no dependents and for taxable years beginning on or after January 1, 2027, for all qualified individuals. The free tax return preparation program will be available beginning on January 20, 2026.

Federal/State Law

Current federal law provides that returns and tax information are confidential and may not be disclosed to federal or state agencies or employees except for authorized purposes. Agencies allowed access to federal return information include certain federal and state agencies, such as the FTB. A federal return is defined as any tax return, information return, declaration of estimated tax, or claim for refund under the IRC. Any FTB employee or member responsible for the improper disclosure of federal tax information is subject to felony criminal prosecution.

Current state tax law provides that information collected from income tax returns is considered confidential and, unless specifically available for other uses, must be used only to administer the income tax laws. The FTB may disclose taxpayer information only in limited circumstances and only to specific agencies as authorized by law. Improper disclosure of federal tax information is punishable as a felony, and improper disclosure of state tax information is punishable as a misdemeanor.

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Federal Law

Current federal law mandates the Internal Revenue Service (IRS) to increase the percentage of returns filed electronically by taxpayers. Through the IRS Free File Program, a public-private partnership between the IRS and tax preparation and filing industry companies, there are two ways taxpayers can prepare and file their federal tax return online for free.

- Under the "Guided Tax Preparation" program, taxpayers with adjusted gross income (AGI) under \$73,000 per year, can receive free online tax preparation and file electronic returns at no cost using private vendors to meet this objective.
- Taxpayers, including those with AGI above \$73,000, can use the "Free File Fillable Forms" program.

State Law

Current state law requires the FTB to develop and make available forms for taxpayers that are as simple as possible for taxpayers to prepare. The FTB is required to ease taxpayers' compliance burden in the form and design of tax returns.

Implementation Considerations

None noted.

Technical Considerations

The FTB has identified the following considerations and is available to work with the author's office to resolve these and other considerations that may be identified.

In subdivision (b) of Section 19551.3, remove "and before January 1, 2022" to continue allowing the sharing of information passed this date.

In Section 19587(b)(3)(D), insert "for the taxable year" after "17052.2".

In Section 19587(d), remove "if CalFile meets the requirements of this section".

This bill uses the following words interchangeably: "California personal income tax returns," "individual income tax return" and "California income tax return," "qualified individuals" and "taxpayers." For consistency, it is recommended that the bill be amended.

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Policy Considerations

The free tax return preparation program proposed by this bill would be available to qualified individuals to file their California personal income tax returns. Individuals would need to file their federal return separately to meet any federal filing requirements or to claim specific federal credits.

The invitations to participate in the free tax return preparation program will be sent annually in March and April. This is likely after many of the qualified individuals will have filed their income tax returns.

With the limited data available to the FTB, qualified individuals will need to correct the information in the prepopulated tax return prior to submitting to ensure proper and accurate return filing.

LEGISLATIVE HISTORY

AB 1002 (Irwin and Caballero, 2023/2024) would, under the AFITL, provide that qualified individuals may claim a qualified credit, as defined, on a form that does not require the qualified individual to file an individual income tax return. This bill would also include a data sharing provision to accomplish this purpose. AB 1002 is currently in the legislative process.

AB 158 (Committee on Budget, Chapter 737, Statutes of 2022), under the AFITL, allowed for the FTB to exchange data with the California DSS, and the DHCS for purposes of identifying taxpayers who may qualify for specified antipoverty credits, Volunteer Income Tax Assistance, and CalFile, among other provisions.

AB 1863 (Irwin, Chapter 953, Statutes of 2022) required the FTB to notify potential eligible individuals of available paperless filing options offered through FTB and to include information in the notification about the CalEITC.

SB 1409 (Caballero, Chapter 114, Statutes of 2020) required the FTB to analyze and develop a plan to increase the number of CalEITC claims and the federal Earned Income Tax Credit. The FTB was required to report to the Legislature by January 1, 2022, its analysis and plan.

AB 1515 (Santiago, 2021/2022) would have established the EITC Grant Program and would have authorized the FTB to allocate grants to qualified nonprofit community-based organizations or local government agencies to increase the number of eligible households claiming the CalEITC and federal EITC, the Golden State Stimulus (GSS), and the YCTC. Grants would have also been provided to existing Volunteer Income Tax Assistance (VITA) clinic contracts to provide free tax preparation assistance and federal individual taxpayer identification number (ITIN) application assistance. AB 1515 did not advance out of the Senate by the constitutional deadline.

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PROGRAM BACKGROUND

CalFile

CalFile is a free, direct online program that allows taxpayers to e-file their California only personal income tax returns with FTB. A MyFTB account provides individuals online access to tax account information and online services. The CalFile program expanded the taxpayer population eligible for this service and also allowed taxpayers to file prior year returns. FTB began utilizing CalFile exclusively as a simplified filing portal for the California return in 2015. This portal also allowed for pre-population of data if taxpayers registered and obtained a MyFTB account. This portal does not provide a mechanism for the taxpayer to file a federal personal income tax return.

Volunteer Income Tax Assistance (VITA) and Tax Counseling for the Elderly (TCE)

Free tax help is available through VITA and TCE. Taxpayers living in California can get free tax help from these programs to file their federal and California personal income tax returns:

VITA is available to taxpayers that:

- Make \$60,000 or less.
- Have disabilities.
- Speak limited English.
- Are active duty or retired military personnel, or a dependent.

TCE is available to taxpayers over 60 years old and specializes in questions about pensions and retirement-related issues unique to seniors.

Report to the Legislature

In 2022, FTB reported to the Legislature potential concepts to increase the number of CalEITC claims and the federal EITC, including alternative filing systems. The concepts included, but were not limited to, the following:

- An overview of the changes to the income tax system that reduced any barriers to tax filing for non-filers of tax returns who were eligible for the CalEITC; and
- An outline of the necessary changes to increase collaboration and coordination among state agencies to reach the greatest number of individuals eligible for the CalEITC.

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New Outreach Beginning Summer 2023

As the result of the report to the legislature and AB 1863, the FTB has been resourced to begin a robust outreach program to target both filers and nonfilers who appear to be eligible for CalEITC, but failed to claim the credit. Beginning in the summer of 2023, the FTB will mail the following letters to filers and non-filers:

- Filers – A letter acknowledging a return was received and information noting that they may have missed the CalEITC. The letter will include marketing material for the CalEITC as well as the CalEITC website and online calculator information to calculate their potential credit.
- Nonfilers – The FTB will identify outreach recipients using filing history and W-2 wage data, to determine a likely credit range. The letter will let taxpayers know that they may be eligible for the credit and include marketing material for the CalEITC as well as the CalEITC website and online calculator information to calculate their potential credit. The letter will direct eligible taxpayers to file a return and include information on CalFile, VITA and the Free File Alliance program to also encourage filing of a federal return.

Most of these individuals receiving outreach letters are also eligible for this free tax return preparation proposal.

FISCAL IMPACT

This bill would impact the FTB systems, resulting in programming, processing, and form revisions as well as the need for taxpayer outreach.

The resources and system changes needed for this proposal as well as the proposal under AB 1002, for a stand-alone filing option, are significantly intertwined, therefore, FTB computed the cost based on both proposals moving forward and then split the total cost equally between the two bills. If only one bill moves forward, FTB will need to reevaluate the cost for the proposal that progresses forward.

The FTB's costs to implement this bill are estimated to be approximately \$0.6 million for fiscal year 2023-24, and \$4.1 million for fiscal year 2024-2025, annual costs of approximately \$7 million for fiscal years 2025-2026 through 2027-28, and ongoing costs of \$4.8 million starting in fiscal year 2028-29.

ECONOMIC IMPACT

Revenue Estimate

This bill as amended April 18, 2023, does not change the way income tax is calculated under the Revenue and Taxation Code (RTC). However, it may change the number of taxpayers filing a tax return.

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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

This bill would not change the way income tax is calculated under the RTC. However, it is estimated that by offering the proposed free tax return preparation program proposed under this bill and the stand-alone filing option proposed under AB 1002, that approximately 49,000 additional qualified taxpayers would file and claim the CalEITC, YCTC, or the FYTC in taxable year 2025 using these new tools and increase to about 145,000 in the 2026 taxable year and ongoing. Additional benefits could include historical filers and claimants that will now choose to file using these new free filing methods.

Taxable Year	2025	2026	2027
Current Year Filer - Non-Claimant	34,000	101,000	107,000
New Filers	15,000	44,000	57,000
Total Number of Additional Filers	49,000	145,000	164,000
Historical Filers/Claimants that will now choose to file using this new tool	90,000	275,000	385,000
Total Number of Individuals Impacted	139,000	420,000	549,000

APPOINTMENTS

None noted.

SUPPORT/OPPOSITION

As per the April 21, 2023, Senate Governance and Finance committee analysis of SB 565, the following support and opposition was noted:

Support

Economic Security Project Action

Opposition

California Taxpayers Association

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ARGUMENTS

None noted.

LEGISLATIVE CONTACT

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