



Bill Analysis

Author: Caballero and Irwin

Bill Number: SB 565

SUBJECT

EITC, YCTC, and FYTC Free Tax Return Preparation Program

SUMMARY

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

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 qualified individuals 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.

This bill also includes language to prevent chaptering issues with AB 1002 (Irwin and Caballero).

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

Data Sharing

This bill would, under the AFITL, expand the existing data sharing provision between the DSS, the DHCS, and the FTB, to require DSS and DHCS to exchange data with FTB that is directly connected with the administration of the free tax return preparation program established under Revenue and Taxation Code (RTC) section 19587, added by this bill. Data that DSS must exchange would include names, addresses, and contact information of individuals that may qualify for the free tax preparation program.

This bill would authorize FTB to disclose return information described above to DSS and DHCS. FTB could use this information for the purposes of implementing to the free tax return preparation program.

This bill includes double-jointing language to incorporate changes proposed by AB 1002 (Irwin and Caballero) to prevent chaptering issues if both bills are enacted.

Free Tax Return Preparation Program

This bill would, under the AFITL, for taxable years beginning on or after January 1, 2025, and before January 1, 2031, 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, and before January 1, 2031, 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, defined as a natural person, that meets all of the following:

- Has filed a California personal 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 for the taxable year.

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

- Provide questions to guide qualified individuals to file their California personal income tax return.
- Allow qualified individuals 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.

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.

This provision would be repealed as of December 1, 2031.

Effective/Operative Date

This bill would be effective on January 1, 2024.

The data sharing provisions in Section 1 of this bill would be operative on January 1, 2024.

The free tax return preparation program would be specifically operative for taxable years beginning on or after January 1, 2025, and before January 1, 2027, 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, and before January 1, 2031, for all qualified individuals. The free tax return preparation program will be available beginning on January 20, 2026.

Section 3 of this bill provides that Section 1.5 of this bill would only become operative, if all of the following occur:

- 1) This bill and AB 1002 are enacted and become effective on or before January 1, 2024,
- 2) Each bill amends Section 19551.3 of the RTC, and
- 3) This bill is enacted after AB 1002, in which case Section 1 of this bill shall not become operative.

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.

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.

Current state law requires DSS and DHCS to exchange information with the FTB and allows the FTB to exchange data with the DSS and DHCS for purposes of identifying taxpayers who may qualify for specified antipoverty credits, Volunteer Income Tax Assistance (VITA), and CalFile.

Implementation Considerations

None noted.

Technical Considerations

None noted.

Policy Considerations

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

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 after wage data is received from the Employment Development Department. This is likely after many of the qualified individuals will have filed their income tax returns. Data shows that these individuals typically file in February and March to claim their refunds.

This bill allows a qualified individual who is an individual with no dependents or who is a spouse filing a separate return with no dependents to participate in this program. A spouse filing a separate return with no qualifying child is not eligible for EITC, YCTC, or FYTC, therefore this type of individual would not meet the requirements to be a qualified individual.

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 has been enrolled.

AB 158 (Committee on Budget, Chapter 737, Statutes of 2022), under the AFITL, required DSS and DHCS to exchange information with FTB and allowed FTB to exchange data with DSS and DHCS for purposes of identifying taxpayers who may qualify for specified antipoverty credits, VITA, 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 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.

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.

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 non-filers who appear to be eligible for CalEITC but failed to claim the credit. Beginning in the summer of 2023, the FTB started mailing 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.
- Non-filers – The FTB will identify outreach recipients using filing history and W-2 wage data, to determine a likely credit range. The letter will inform taxpayers 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 2023-2024, and \$4.1 million for fiscal year 2024-2025, annual costs of approximately \$7 million for fiscal years 2025-2026 through 2027-2028, and ongoing costs of \$4.8 million starting in fiscal year 2028-2029.

ECONOMIC IMPACT

Revenue Estimate

This bill as amended September 8, 2023, does not change the way income tax is calculated under the RTC. However, it may change the number of taxpayers filing a state tax return.

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 free state tax return preparation program proposed under this bill and the simplified filing experience 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 would increase to about 145,000 in the 2026 taxable year and ongoing. Additional benefits could include historical filers and claimants that would now choose to file using one of 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 the new tools	90,000	275,000	385,000
Total Number of Individuals Impacted	139,000	420,000	549,000

LEGAL IMPACT

None noted.

APPOINTMENTS

None noted.

SUPPORT/OPPOSITION

As per the September 14, 2023, Senate Floor analysis of SB 565, the following support and opposition was noted.

Support

All Home
Economic Security Project Action

Opposition

California Taxpayers Association

VOTES

Location	Date	Yes Votes	No Votes
Concurrence	September 14, 2023	32	8
Assembly Floor	September 13, 2023	62	15
Senate Floor	May 24, 2023	32	6

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