STATE OF CALIFORNIA
Franchise Tax Board

Bill Analysis

Author: González, Rodriguez, Sharp-Collins, et al.

Sponsor:

Bill Number: AB 397

Related Bills: See Legislative History

Introduced: February 3, 2025

SUBJECT

Young Child Tax Credit – Qualifying Child Expansion

SUMMARY

This bill, under the Personal Income Tax Law (PITL), for taxable years beginning on or after January 1, 2025, would expand eligibility for the Young Child Tax Credit (YCTC) by gradually increasing the age of a "qualifying child" to have the same age limitation as under the California Earned Income Tax Credit (CalEITC) for taxable years beginning on or after January 1, 2028.

RECOMMENDATION

No position—The three-member Franchise Tax Board has not formally voted or taken a position on this bill.

SUMMARY OF AMENDMENTS

Not applicable.

REASON FOR THE BILL

The reason for this bill is to expand eligibility for the YCTC by gradually increasing the age limitation for a qualifying child until the age limitation is the same as under the CalEITC.

ANALYSIS

Under the PITL, this bill would modify the meaning of a "qualifying child" for purposes of the YCTC, by annually increasing the age requirement from six years old as of the last of the taxable year until the age requirement is the same as under the CalEITC. The bill modifies the definition as follows:

- For the taxable year beginning on or after January 1, 2025, and before January 1, 2026, the definition of a "qualifying child," would be expanded to include children who are younger than 10 on the last day of the taxable year.

- For the taxable year beginning on or after January 1, 2026, and before January 1, 2027, the definition of a "qualifying child" would be expanded to include children who are younger than 13 years of age as of the last day of the taxable year.
- For the taxable year beginning on or after January 1, 2027, and before January 1, 2028, the definition of a "qualifying child" would be expanded to include children who are younger than 16 years of age as of the last day of the taxable year.
- For each taxable year beginning on or after January 1, 2028, the definition of "qualifying child" would have the same meaning as under the CalEITC, which requires that the individual is younger than the qualified taxpayer and either has not reached the age of 19 at the close of the tax year or has not reached the age of 24 at the close of the tax year if they are a student. Additionally, permanently and totally disabled individuals would be included as meeting the age criteria for a qualifying child for the YCTC.

In conjunction with existing Section 41 reporting requirements for the YCTC, this bill would require the Franchise Tax Board (FTB) to separately state, for taxable years beginning on or after January 1, 2025, the following:

- The number of tax returns claiming the credit,
- The number of qualifying children represented on tax returns claiming the credit, and
- The average credit amount on tax returns claiming the credit.

Additionally, the report must include an estimate of what the above performance measures would have been absent the changes proposed in this bill.

Effective/Operative Date

This bill would be effective January 1, 2026, and specifically operative for taxable years beginning on or after January 1, 2025.

Federal/State Law

Federal Law

Earned Income Tax Credit (EITC)

Existing federal law allows eligible individuals a refundable 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 2024, the EITC is available to individuals and families earning up to $66,819.

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) issued on or before the due date of the tax return, or
- Resident alien who was in the U.S. at least 6 months of the year and has a valid SSN issued on or before the due date of the tax return.

Certain individuals are specifically excluded from the definition of an eligible individual, including, 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, have a valid SSN issued on or before the due date of the tax return, 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.

Child Tax Credit (CTC)

Federal law allows a CTC for 2024, as follows:

- 2,000 per qualifying child
- A refundable portion up to $1,700 per qualifying child

The credit applies if the child is younger than 17 at the end of the tax year, has a valid SSN issued on or before the due date of the tax return, including extensions, and the child lives with the taxpayer for more than six months of the year and can be claimed by the taxpayer as a dependent. The credit is subject to income limits.

State Law

California Earned Income Tax Credit (CalEITC)

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

For 2024, the CalEITC is generally available to taxpayers with earned income of $31,950 or less.

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.

The age requirement for a "qualifying child," in general, is an individual that is younger than the eligible individual claiming such individual as a qualifying child and the following applies:

- has not attained the age of 19 as of the close of the calendar year in which the taxable year of the taxpayer begins, or
- is a student who has not attained the age of 24 as of the close of such calendar year.

With regards to an individual who is permanently and totally disabled, at any time during such calendar year, the above age requirements would be treated as met.

Young Child Tax Credit (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.

For taxable years beginning on or after January 1, 2022, an individual that is otherwise eligible for the CalEITC but has no earned income, may be eligible for the YCTC. In addition, the maximum amount of the YCTC, initially set at $1,000, is annually indexed for inflation. The credit amount is phased out as a qualified taxpayer's earned income exceeds the threshold amount, initially set at $25,000. For taxable years beginning on or after January 1, 2023, the threshold amount will be indexed for inflation. For 2024, the YCTC is generally available to taxpayers with earned income of $31,950 or less.

Minimum Income Thresholds

For taxable years beginning on or after January 1, 2024, the YCTC and Foster Youth Tax Credit (FYTC) are required to have the same maximum income threshold as the CalEITC.

Section 41

Under Revenue and Taxation Code (RTC) section 41, legislation that would create a new tax expenditure, which includes a credit, deduction, exemption, or any other tax benefit as provided for by the state, is required to include specific goals, purposes, objectives, and performance measures to allow the Legislature to evaluate the effectiveness of the tax benefit.

Implementation Considerations

None noted.

Technical Considerations

For consistency with other provisions of the RTC, the following changes should be made:

In Section 17052.1 (c)(2), (3), (4), and (5) remove, "For each taxable year" and replace with "For taxable years."

This bill would gradually increase the age requirement of a "qualifying child" to match the definition of the CalEITC. The author may wish to consider removing "young" from the name of the credit.

Policy Considerations

None noted.

LEGISLATIVE HISTORY

SB 167 (Committee on Budget & Fiscal Review, Chapter 34, Statutes of 2024) amongst other provisions, under the PITL, for taxable years beginning on or after January 1, 2024, aligned the maximum income thresholds of the YCTC and FYTC with the CalEITC. Required the FTB to calculate the graduated reduction amount in such a manner that would result in the YCTC and FYTC earned income phase out amounts to match the earned income phase out amount of the CalEITC.

SB 201 (Committee on Budget & Fiscal Review, Chapter 72, Statutes of 2022), amongst other provisions, under the PITL, for taxable years beginning on or after January 1, 2022, modified the YCTC to expand the definition of a qualified taxpayer, and provided for indexing of the YCTC as well as made other technical nonsubstantive changes.

AB 91 (Burke, et al., Chapter 39, Statutes of 2019) amongst other provisions, created the YCTC operative for taxable years beginning on or after January 1, 2019.

AB 1128 (Santiago, et al., 2023/2024) under the PITL, would have expanded the eligibility of the YCTC by changing the definition of a qualifying child to have the same meaning as under the CalEITC. AB 1128 did not pass out of the Assembly by the constitutional deadline.

AB 2977 (Jackson, 2023/2024) under the PITL, would have expanded the YCTC by increasing the earned income threshold from $25,000 to $50,000 and modify the definition of a qualifying child from younger than 6 years of age to younger than 1 8 years of age. AB 2977 did not pass out of the Assembly by the constitutional deadline.

PROGRAM BACKGROUND

None noted.

OTHER STATES' INFORMATION

None noted.

FISCAL IMPACT

The FTB's costs to implement this bill have yet to be determined. As the bill moves through the legislative process, costs will be determined.

ECONOMIC IMPACT

Revenue Estimate

This bill would result in the following revenue loss:

Estimated Revenue Impact of AB 397 as Introduced on February 3, 2025
Assumed Enactment after June 30, 2025

($ in Millions)

Fiscal Year	Revenue*
2025-2026	-$220
2026-2027	-$370
2027-2028	-$550

*The estimated revenue loss increases to $700 million in the 2028-29 fiscal year.

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 FTB's YCTC micro-simulation model, it is estimated that changing the age limit of a qualifying child for the YCTC from under 6 years old to under 10 years old would result in an additional revenue loss of approximately $220 million in the 2025 taxable year. With each subsequent year, the qualifying child's minimum age would be expanded until the YCTC qualifying child is the same as a CalEITC qualifying child. This results in an estimated additional revenue loss of $700 million in the 2028 taxable year.

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.

EQUITY IMPACT

None noted.

APPOINTMENTS

None noted.

SUPPORT/OPPOSITION

To be determined.

ARGUMENTS

To be determined.

LEGISLATIVE CONTACT

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