STATE OF CALIFORNIA
Franchise Tax Board

Bill Analysis

Author: Ahrens

Sponsor:

Bill Number: AB 398

Related Bills: See Legislative History

Introduced: February 4, 2025

SUBJECT

California Earned Income Tax Credit – Minimum Credit Amount

SUMMARY

This bill would, under the Personal Income Tax Law (PITL), establish a minimum amount for the California Earned Income Tax Credit (CalEITC), that would be indexed annually for inflation and include a phaseout of the minimum credit.

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 establish a minimum CalEITC credit.

ANALYSIS

Under the PITL, for taxable years beginning on or after January 1, 2025, this bill would modify the CalEITC by establishing a minimum credit amount. To accomplish this, the bill would provide that if the CalEITC amount computed for an eligible individual is less than $355, multiplied by the earned income tax credit adjustment factor then the credit would be equal to $355, multiplied by the earned income tax credit adjustment factor for that taxable year. The CalEITC adjustment factor is determined annually and is currently 85%.

This bill would, for taxable years beginning on or after January 1, 2026, require the $355 minimum credit amount to be indexed for inflation.

Additionally, this bill would apply a phaseout to the minimum credit amount. The minimum amount credit amount would be reduced by an amount as determined by the FTB for each $100, or fraction thereof by which the qualified taxpayer's Adjusted Gross Income, or if greater, earned income, exceeds the threshold amount. The credit would be completely phased out at the same earned income amount as the CalEITC.

The threshold amount would be as follows:

- For taxable years beginning on or after January 1, 2025, and before January 1, 2026, the amount would be $15,000.
- For taxable years beginning on or after January 1, 2026, and before January 1, 2027, the amount would be $20,000.
- For taxable years beginning on or after January 1, 2027, and before January 1, 2028, the amount would be $28,000.

This bill would, for each taxable year beginning on or after January 1, 2028, require the $28,000 threshold amount be indexed for inflation.

In conjunction with existing Section 41 reporting requirements, this bill would require the 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 individuals represented on tax returns claiming the credit,
- The average credit amount on tax returns claiming the credit,
- The distribution of credits by number of dependents and income ranges. The income ranges would encompass the phase-in and phaseout ranges of the credit, and
- Using data from tax returns claiming the credit, including an estimate of the federal earned income tax credit determined, an estimate of the number of families who are lifted out of deep poverty by the credit and an estimate of the number of families who are lifted out of deep poverty by the combination of the credit and the federal earned income tax credit. A family is in "deep poverty" if the income of the family is less than 50 percent of the federal poverty threshold.

Additionally, the report must include an estimate of what the above performance measures would have been absent the CalEITC 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 Earned Income Tax Credit (EITC) under Internal Revenue Code (IRC) section 32. The 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. 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

CalEITC

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.

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.

Section 41

Under Revenue and Taxation Code 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

None noted.

Policy Considerations

None noted.

LEGISLATIVE HISTORY

SB 201 (Committee on Budget, Chapter 72, Statutes of 2022), amongst other provisions, under the PITL, specified that the CalEITC phaseout percentages as recalculated for taxable year 2022 would apply to taxable year 2023 and later.

AB 397 (González, Rodriguez, Sharp-Collins, et al., 2025/2026), under the PITL, would for taxable years beginning on or after January 1, 2025, modify the meaning of a "qualifying child" to gradually expand eligibility for the Young Child Tax Credit for specified years. AB 397 is currently in the Assembly Revenue and Taxation Committee.

AB 1498 (Gipson, 2023/2024) would have, under the PITL, established a minimum CalEITC, subject to appropriation, would have provided for the indexing of the minimum credit amount, and would have provided for a phaseout of the minimum credit. AB 1498 did not pass out of the Assembly by the constitutional deadline.

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 Young Child Tax Credit 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.

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 398 as Introduced on February 4, 2025
Assumed Enactment after June 30, 2025

($ in Millions)

Fiscal Year	Revenue
2025-2026	-$180
2026-2027	-$260
2027-2028	-$400

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

Using the output from the FTB's EITC micro-simulation model, it is estimated that changing the CalEITC credit calculation to allow a $355 minimum credit (after the adjustment factor) along with a threshold amount of $15,000 would result in an additional revenue loss of $180 million in the 2025 taxable year. With each subsequent year, the revenue loss would increase as the threshold amount is increased. This results in an estimated additional revenue loss of $400 million in the 2027 taxable year when the threshold amount is set at $28,000.

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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