DEPARTMENT OF FINANCE BILL ANALYSIS

AMENDMENT DATE: 05/16/2012
POSITION: Oppose

BILL NUMBER: AB 1974
AUTHOR: Dickinson, Roger

BILL SUMMARY: Income Taxes: Earned Income Tax Credit

This bill would, for tax years beginning on or after January 1, 2012, allow a state tax credit equal to 15% of the federal Earned Income Tax Credit (EITC).

FISCAL SUMMARY

According to the Franchise Tax Board (FTB), this bill would result in revenue losses of $110 million in 2012-13, $100 million in 2013-14, and $110 million in 2014-15 if no appropriation by the Legislature is made. Assuming an appropriation by the Legislature is made, the FTB estimates revenue losses of $1 billion in 2012-13, $900 million in 2013-14, and $900 million in 2014-15.

The FTB states that this bill's requirements would impact its programming, printing, processing, mailing, and storage costs for tax returns. The FTB has not yet determined these costs as of the date of this analysis.

COMMENTS

The Department of Finance is opposed to this bill as it would result in significant revenue losses in a time of fiscal crisis and budget deficits for the state. Further, FTB notes several implementation concerns with this bill, including the issue that, historically, they have had significant problems with refundable credits and fraud. These problems are aggravated because if a refund is made that is later determined to be fraudulent, the refund commonly cannot be recovered.

Note: FTB also notes that this bill contains provisions that would target certain incentives to residents of California while denying the same incentives to nonresidents. The U.S. Supreme Court in *Lunding Et Ux. v. New York Appeals Tribunal et al.* (1998), found that denying a tax benefit to a nonresident taxpayer, while allowing such a benefit to resident taxpayers, was discriminatory and thus unconstitutional. Consequently, an EITC conditioned on full-year residency in California may be subject to constitutional challenge.

ANALYSIS

1. Programmatic Analysis

   Current 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 credit is a percentage of the taxpayer's earned income and is phased out as income increases. The percentage varies, based on whether the taxpayer has qualifying children. Married individuals are eligible for only one credit on their combined earned income and must file a joint return to claim the credit.

   Under provisions of federal law, certain individuals not lawfully admitted for permanent residence in the United States are ineligible for federal, state, and local public benefits, including the EITC. The

ANALYSIS (continued)

IRS delays all returns claiming the federal EITC that do not pass an automated social security number verification process.

Current state law does not provide an EITC. Existing state laws provide various tax credits designed to provide tax relief for taxpayers that incur certain expenses (e.g., child and dependent care credits), to influence business practices and decisions, or to achieve social goals. Credits are allowed against net tax based on a set order of priority as specified in the Revenue and Taxation Code.

Under current state law , individuals with income below the filing thresholds are not required to file an income tax return because the standard deduction and personal exemption credit eliminate any tax liability. For 2011, these thresholds are $15,152 in gross income or $12,122 in adjusted gross income (AGI) for single taxpayers and $30,305 in gross income or $24,244 in AGI for married filing joint taxpayers. These thresholds are increased based on the number of dependents claimed and are increased annually for inflation.

This bill would allow a refundable state EITC equal to 15 percent of the version of the federal EITC in effect as of January 1, 2012. Any state credit in excess of the state tax liability would be credited against other amounts due and can be carried over to succeeding taxable years until the credit is exhausted. The refunded portion of the state EITC would be provided, upon appropriation from the Legislature, from the Tax Relief and Refund Account. If the amounts refunded to taxpayers exceed the amount available in the Tax Relief and Refund Account, the FTB shall establish a wait list for refunds with priority given by date of taxpayer return.

This bill specifies that no credit shall be allowed to (1) any person who is treated as a nonresident for any portion of the taxable year, or (2) any person who is married and files a separate return for the taxable year.

Many taxpayers eligible for the federal EITC have no California income tax return filing requirement. These nonfilers would be required to file a California income tax return to claim the proposed state EITC.

DISCUSSION:

A background sheet provided by the author's office stated the following: "In this economic climate, an EITC can provide needed assistance to low income working families and their children. In a report for the Public Policy Institute of California, Davide Neumark found that, in contrast to a hiring credit, which increases labor demand, the EITC increases labor supply. Because the EITC raises a worker's effective wage (the market wage plus the EITC subsidy), it encourages people to work. In sum, Dr. Neumark found, worker subsidies in the form of an EITC have two benefits. They induce people to take jobs, which increases employment, and in so doing , these subsidies increase the incomes of poor and low-income families. Currently 26 states have enacted state EITCs."

Finance notes that based on the reasons cited in the fact sheet, it would appear that a wage subsidy would be ineffective at stimulating economic growth during this time when there is, generally, insufficient labor demand.

The FTB notes that historically, the FTB has had significant problems with refundable credits and fraud. These problems are aggravated because if a refund is made that is later determined to be

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Dickinson, Roger	05/16/2012	AB 1974

ANALYSIS (continued)

fraudulent, the refund commonly cannot be recovered. The FTB feels that striking the refundability provision from this credit would substantially reduce the department's concerns regarding fraud.

2. Fiscal Analysis

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	SO	(Fiscal Impact by Fiscal Year)						
Code/Department	LA	(Dollars in Thousands)						
Agency or Revenue	CO	PROP						Fund
Type	RV	98	FC	2011-2012	FC	2012-2013	FC	2013-2014	Code
1147/Pers Inc Tax	RV	Yes	U	0	U	-1,000,000	U	-900,000	0001
1730/FTB	SO	No		----- See Fiscal Analysis -----					0001