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L E G I S L A T I V E A N A L Y S T ' S O F F I C E

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Background on the California EITC

Presented to:
Assembly Budget Subcommittee No. 4
On State Administration
Hon. Adrin Nazarian, Chair



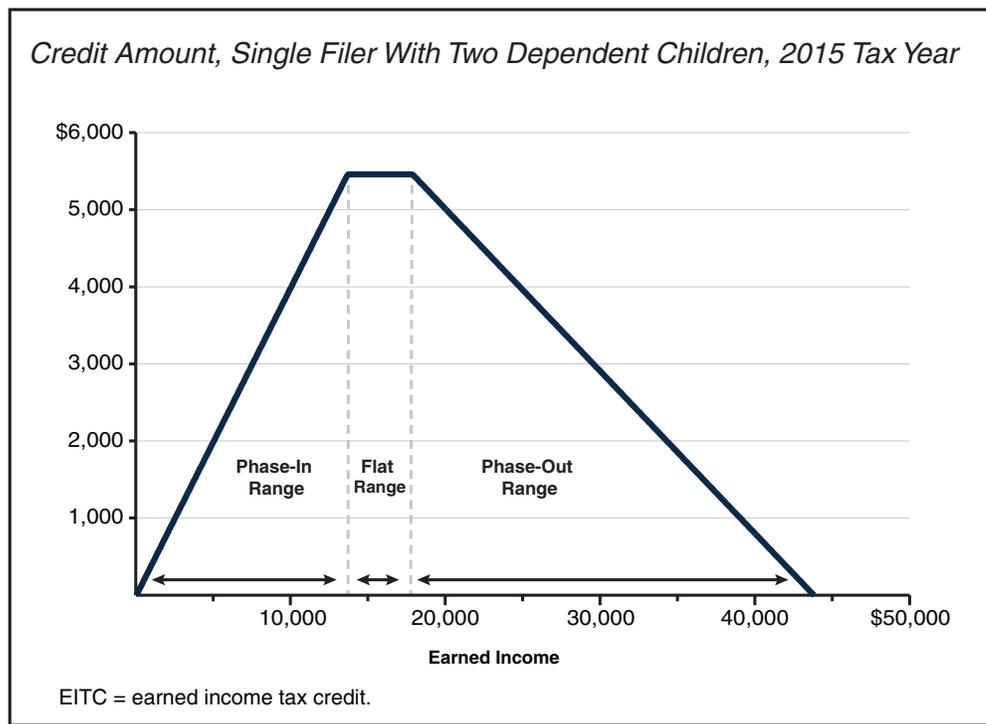


California Earned Income Tax Credit (EITC) Adopted as Part of 2015-16 Budget Package

- California EITC Intended to Reduce Poverty Among Very Low-Income, Working Families.*** The California EITC is a personal income tax (PIT) credit that is intended to reduce poverty among California's poorest working families by increasing their after-tax income. For those tax filers who qualify, the credit reduces income tax liability. In the common case where the amount of the credit exceeds the filer's liability, the difference is paid to the filer as a tax refund.

- Estimated Eligible Filers and Cost.*** At the time the 2015-16 budget was enacted, it was estimated that 2 million individuals (825,000 tax returns) would qualify for the California EITC for tax year 2015, the first year the credit is available. The California EITC was estimated to reduce PIT revenues available to the General Fund in 2015-16 by \$380 million dollars. The 2015-16 budget also includes \$22 million (General Fund) for the Franchise Tax Board to implement and administer the credit during 2015-16. Because taxes are still being filed for tax year 2015, the final cost and number of qualifying Californians is not yet known.

Basic Structure of the Federal EITC

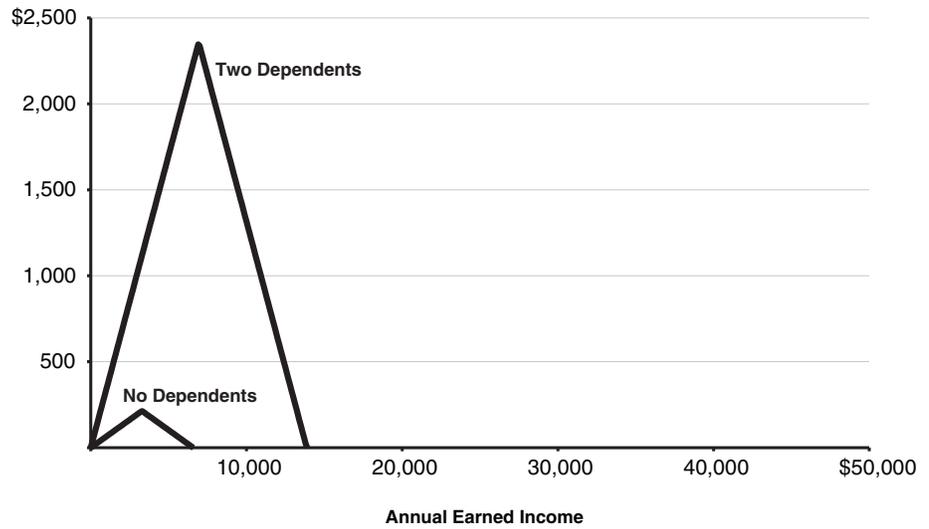


What Is the Federal EITC? The federal EITC is a fully refundable income tax credit that reduces tax liability for filers with earnings. The amount of the federal EITC initially rises with earnings, such that the greater the filer’s earnings, the larger the credit. For higher levels of earnings, the federal EITC peaks and then gradually phases out. The federal EITC benefit can be significant—for tax year 2015, filers with three or more qualifying dependent children may claim up to \$6,242, with lesser amounts available for filers with fewer qualifying children. Filers with no qualifying dependent children receive a much smaller maximum benefit of only \$503.

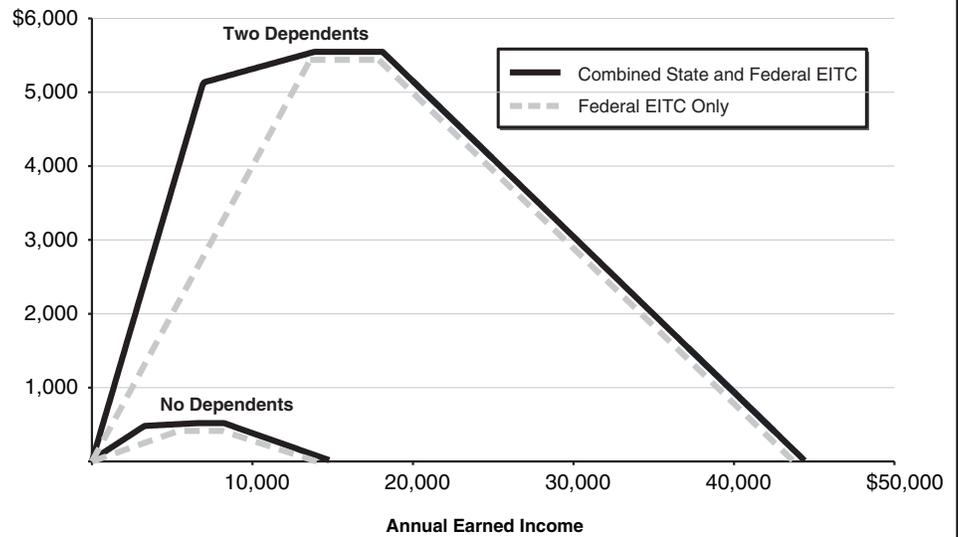


Basic Structure of the California EITC

State Credit Amount for Single Filers, 2015 Tax Year



Combined State and Federal Credit Amount, 2015 Tax Year



EITC = earned income tax credit.



Major Features of the California EITC

- Builds on the Federal EITC.*** The California EITC is structured to match 85 percent of the federal EITC for earnings in the lower half of the federal EITC’s phase-in range. For higher levels of earnings up to the end of the federal EITC’s phase-in range, the California EITC phases out, such that the households that qualify for the maximum federal EITC no longer qualify for the California EITC.

- Focuses on Working Families With the Lowest Incomes.*** This structure focuses the benefits of the California EITC on working families with very low earnings—specifically, less than \$13,870 per year. By way of context, this is equivalent to the annual earnings of working a little less than 30 hours a week at minimum wage. Similar to the federal EITC, tax filers with three or more qualifying dependents may claim the largest credit and filers with one or two dependents receive less. Filers with no qualifying dependents may receive a very small credit.

Maximum California Earned Income Tax Credit Amounts			
<i>2015 Tax Year</i>			
	Maximum Credit	Annual Wages to Receive Maximum Credit	Annual Wages to No Longer Qualify for Credit
No qualifying dependents	\$214	\$3,290	\$6,580
One qualifying dependent	1,428	4,940	9,880
Two qualifying dependents	2,358	6,935	13,870
Three or more qualifying dependents	2,653	6,935	13,870



Major Features of the California EITC

(Continued)

- Excludes Self-Employment Income.*** The federal EITC has historically had a high level of improper payments to individuals who claimed a larger credit than they are eligible to receive. One common source of improper payments in the federal EITC is the misreporting of self-employment income. In order to limit improper payments resulting from misreported self-employment income, the California EITC defines earnings more narrowly than the federal EITC to only include wages subject to withholding—effectively excluding self-employment income.

- Amount of Credit Set Through Annual Budget Act.*** As noted above, for tax year 2015, the California EITC matches up to 85 percent of the federal EITC, over the federal EITC's phase-in range. State law provides that this matching percentage is to be set each year through the annual budget process. The Governor's 2016-17 budget proposes to continue the California EITC with a matching rate of 85 percent.