AGENDA

ASSEMBLY COMMITTEE ON REVENUE AND TAXATION

ASSEMBLYWOMAN AUTUMN R. BURKE, CHAIR

AND

ASSEMBLY BUDGET SUBCOMMITTEE NO. 4 STATE ADMINISTRATION

ASSEMBLYMEMBER JIM COOPER, CHAIR

TUESDAY, MARCH 12, 2019
1:30 P.M. - STATE CAPITOL, ROOM 447

ITEMS TO BE HEARD

ITEM	DESCRIPTION	
7730	**FRANCHISE TAX BOARD**	1
ISSUE 1	GOVERNOR'S WORKING FAMILIES TAX CREDIT AND TAX CONFORMITY PROPOSAL	1

ITEMS TO BE HEARD

FRANCHISE TAX BOARD

ISSUE 1: GOVERNOR'S WORKING FAMILIES TAX CREDIT AND TAX CONFORMITY PROPOSAL

The Governor's budget includes a tax proposal that expands tax credits for working families offset with new revenue generated from tax conformity.

BACKGROUND

The Governor's January budget proposal includes a $1 billion tax reform proposal that would dramatically expand tax credits for working families with offsetting revenue increases from adopting certain tax conformity changes. The proposal has two distinct parts outlined below:

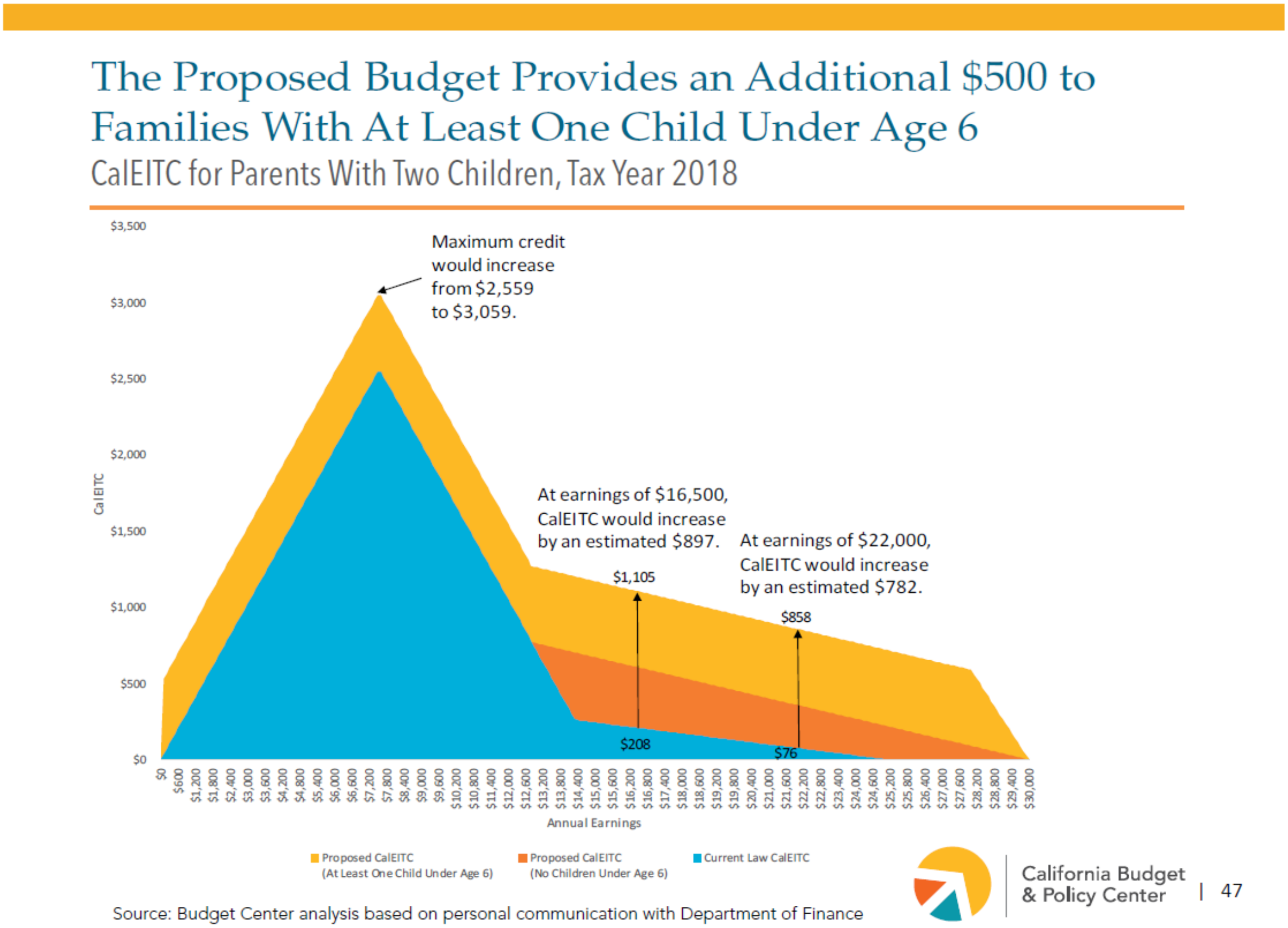
1. Expanding Tax Credits for Working Families

The Governor's Budget proposes to more than double the size of the current California Earned Income Tax Program. This new program for low-income Californians includes an additional $500 credit for families with children under the age of 6. The proposal also increases the maximum eligible earned income so that workers working up to full-time at the 2022 minimum wage of $15 per hour will be eligible for the credit, and changes the phase-out formula so that taxpayers earning income at the upper end of the credit structure will receive significantly higher credit amounts. In addition, the Budget proposes to explore how to allow workers to receive a portion of their CalEITC in monthly payments, as opposed to receiving the credit in one lump sum via their income tax refund. These changes are expected to provide $600 million in additional benefits and to allow one million additional families to benefit from the credit.

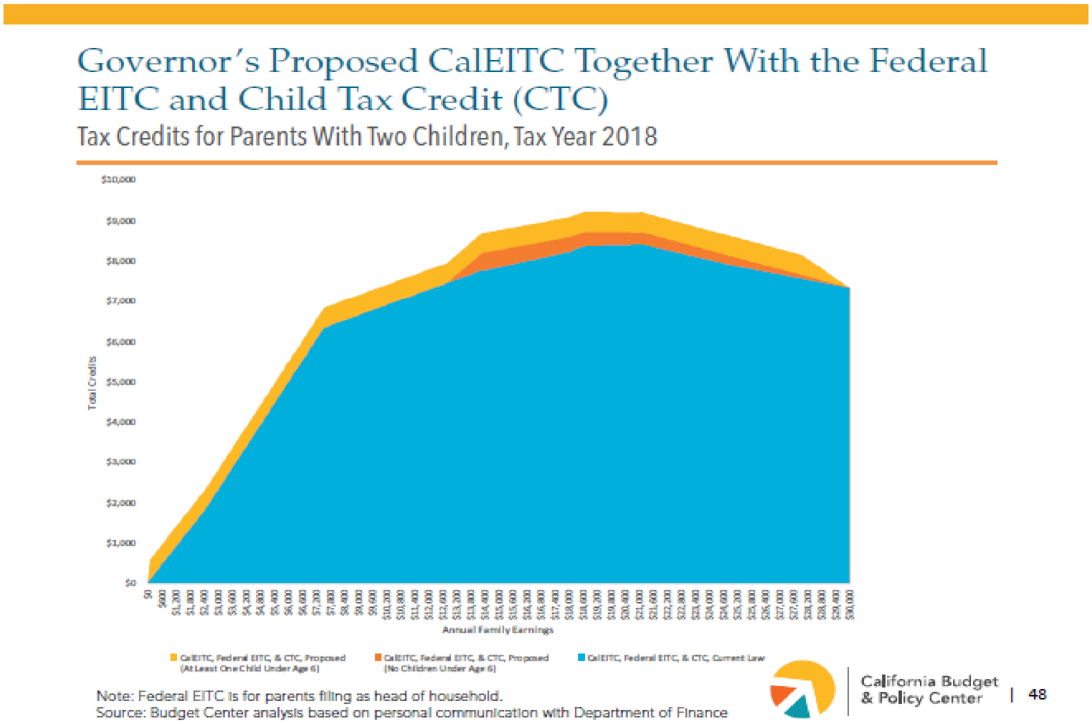
When added to the existing EITC program, the expanded program is expected to provide $1 billion in credits to three million families.

The California Budget and Policy Center has produced the following two graphs to illustrate how this expanded credit would interact with the existing CalEITC and federal EITC programs for a family with two children.

The chart below illustrates how the new CalEITC expansion (in red) builds upon the existing State credit annual family earnings:



CalEITC complements the federal EITC program. The graph below shows how the two programs would interact and how the proposed expansion would build upon e existing programs.



2. Tax Conformity

To pay for this expanded program, the Administration proposes conformity to several federal tax law changes mainly impacting business income. In 2017, the federal government adopted sweeping changes to the tax code for corporations and individuals. The Governor's budget proposes conformity to several key provisions. These provisions include increased flexibility for small business accounting; capital gains deferrals and exclusions for Opportunity Zones; and limitations on fringe benefit deductions, like-kind exchanges, and losses for non-corporate taxpayers; among others. These conformity provisions are expected to generate $1.7 billion in 2019-20.

The Administration provided the following table that reflects their updated proposal:

Conformity Proposal

	Revenue Impact ($ millions)		
	2018-19	2019-20	2020-21
Section 13102 Small Business Accounting Method Reform and Simplification	-310	-240	-90
Section 13504 Repeal of Technical Termination of Partnerships		10	5
Section 13303 Limit Like-Kind Exchanges to Real Property		260	200
Section 13304 Limitation on Fringe Benefits		200	160
Section 13601 Modification of Limitation on Excessive Employee Remuneration		43	37
Section 11024 Increased Contributions to ABLE accounts		-0.4	-0.2
Section 11025 Allow 529 plans to rollover to ABLE accounts		-0.4	-0.2
Section 11012 Limitation on Losses for Taxpayers Other than Corporations		1200	850
Section 13531 Limitation on Deduction for FDIC Premiums		65	55
Not in TCJA Eliminate Separate Section 338 Election		70	65
Section 13823 Opportunity Zones*		-80	-80
Section 13302 Eliminate NOL Carrybacks	360	200	190
Section 11031 - Treatment of Student Loans Discharged on Account of Death or Disability		-1	-0.5
Total	50	1726.2	1391.1

LAO COMMENTS

Expanding the EITC would provide benefits to low-income workers. There are a variety of approaches to helping these workers beyond those proposed by the Governor depending on the Legislature's priorities. The extent to which the Legislature wishes to prioritize reducing poverty, increasing workforce participation, or encouraging full-time work should drive the ultimate design of the expansion.

The LAO has provided the following chart that illustrates the elements of the Governor's proposal:

Assessment of Governor's Conformity Proposal as of March 1, 2019

Conformity Provision	Effects of Change	LAO Assessment	Estimated Revenue Effect[a] (In Millions) 2019-20	2020-21
Limits Non-Corporate Business Losses	Business owners with a loss over $250,000 would be unable to deduct the entire amount in the current year. For fewer than 100,000 filers, conforming would increase tax payments in the current year and reduce payments in future years.	+	$1,200	$850
Eliminates NOL Carrybacks	Eliminates NOL carrybacks—which currently allow a filer to claim a refund of taxes paid for up to two years prior. Conforming may increase state fiscal certainty.	+	$200	$210
Changes Like-Kind Exchange Rules	Eliminates like-kind exchanges of personal property. Conforming would mean that filers could no longer defer capital gains on personal property.	+/-	260	200
Limits Deductions for Fringe Benefits	Changes rules regarding business deductions for entertainment, food, and transportation expenses. Conforming would somewhat increase business taxes.	+	200	160
Increases Flexibility for Small Business Accounting	Increases to $25 million the annual revenue threshold for certain tax accounting rules. Conforming would eliminate differences between state and federal law that increase tax compliance costs for some small businesses.	+	-$220	-$100
Opportunity Zones	Allows filers to defer capital gains if those profits are reinvested in "green technology" or "affordable housing" investments in Opportunity Zones.	N/A	-80	-80
Eliminates Separate Section 338 Election	Eliminates differences between state and federal law regarding the tax treatment of corporate mergers and acquisitions.	N/A	70	65
Limits Deductions of FDIC Premiums	Limits the deduction of deposit insurance premiums paid by banks.	N/A	65	55
Expands limits on excess employee compensation.	Eliminates the performance-based compensation exception from limits on excessive employee compensation and expands the number of employees affected.	N/A	43	37
Repeals "Technical Termination" of Partnerships	Changes tax rules that apply when there is a significant change (more than 50 percent) in the ownership of a partnership.	N/A	10	5
Treatment of Student Loans Discharged on Account of Death or Disability	Excludes the discharge of student loan debt in case of death or disability from income.	N/A	-1	-1
Allows Increased Contributions to ABLE Accounts	Changes some rules regarding contributions to an ABLE account. The maximum total contribution of $14,000 per year remains unchanged.	N/A	—	—
Allows Rollovers to ABLE Accounts	Allows an individual with a disability to convert a "Section 529" educational savings account to an ABLE account without penalty.	N/A	—	—
Estimated Net Change in Revenue			**$1,746**	**$1,401**

[a] We use estimates provided to us by the Franchise Tax Board. In some cases, the estimates differ by the low tens of millions of dollars from those cited by the Department of Finance. There may be minor differences in assumptions.

ABLE = Achieving Better Life Experiences; FDIC = Federal Deposit Insurance Corporation; and NOL = Net Operating Loss.

Legend

+	The arguments in favor of conforming are somewhat stronger than those against.
+/-	There are good arguments both in favor and against conforming.
-	The arguments against conforming are somewhat stronger than those in favor.
N/A	Not applicable. Not included in Legislative Analyst's Office analysis.

PANELISTS

- Jay Chamberlain, Department of Finance
- Brian Weatherford, Legislative Analyst's Office
- Justin Garosi, Legislative Analyst's Office

STAFF COMMENTS

The proposed increase in the CalEITC is consistent with a priority included in the "Assembly 2019-20 Blueprint for a Responsible Budget" and is in line with a long-standing priority of the Assembly.

While the Governor's proposal elicits excitement for its goals and approach, the corresponding tax conformity changes are an unknown. There is no public proposal or language available so the Assembly has not yet heard from stakeholders. With the programs chained together, the need for thoughtful conversation and analysis of the conformity items tempers the elations around the CalEITC expansion. Given that the Assembly anticipated closing out Subcommittees 72 days from the date of this hearing, it is unclear if this proposal will be ready in time to be considered as part of the 2019 budget package.

Additionally, the Governor's proposal lacks an important component, allowing taxpayers that use an Individual Taxpayer Identification Numbers (ITINs) to claim the benefit. Without including these families, up to 1.1 million low-income working taxpayers and their families will fail to benefit from the credit.

One long-standing Assembly goal has been to make the refundable CalEITC, payable on a monthly basis instead of a yearly lump sum, so that families can see the benefit throughout the year. Currently, the Franchise Tax Board lacks the infrastructure and the resources to issue monthly disbursements of the tax credit. There are also considerations relating to reporting requirements and payment mechanisms that will need stakeholder input. The Assembly intends to take action in the budget to begin the process of creating a monthly refundable tax credit mechanism, so that this complicated conversation can begin a soon as possible.

According to the Department of Finance, the Administration now would like to keep the CalEITC program name, instead of an earlier proposal to rename the program the "Working Family Tax Credit".

The Governor's Budget also proposes $5 million for CalEITC outreach and free tax preparation at the Office of Planning and Research, which would move this function from away Franchise Tax Board. The Subcommittee will hear this proposal at our March 26th hearing.

Staff Recommendation: Hold Open.

This agenda and other publications are available on the Assembly Budget Committee's website at: https://abgt.assembly.ca.gov/sub4hearingagendas and may be contacted at (916) 319-2099. This agenda was prepared by Christian Griffith.