SB 276: Earned Income Tax Credit: 2020 Credit Calculation

Senator Rosilicie Ochoa Bogh

IN BRIEF

SB 276 will support low-to-moderate income working families who qualify for CalEITC by authorizing taxpayers to choose between their 2019 and 2020 incomes when filing for the credit.

THE ISSUE

CalEITC (California Earned Income Tax Credit) reduces the tax burden of low-to-moderate income earners by providing a refundable tax credit to eligible individuals. To qualify you must have earned an income (that is subject to California withholdings) of greater than $1, but you cannot earn more than a specified amount. This creates a focused approach to fighting poverty among working families, especially those with young children. Of the largest social safety net programs, the combined federal and state Earned Income Tax Credit programs lower poverty rates the most[1]. CalEITC calculates the credit for qualified individuals based on a percentage of earned income and number of children. Both individuals with an employer and self-employed individuals may file for CalEITC. Unemployment disqualifies an individual from receiving CalEITC, because unemployment insurance (UI) is taxable income, but not "earnings." The tax credit received by filers fluctuates based on earnings and the number of dependents. For low income filers, generally below $10,000 in earnings, the tax credit can increase as income increases. For filers with earnings generally between $10,000 and $30,000, the tax credit can decrease as earnings increase; again dependent upon the number of children claimed with the tax credit[2]. If the amount the individual receives for the credit is greater than the taxes owed, the residual amount is given to the individual as a tax refund[3].

Individuals who receive a tax refund from the credit typically spend the refund on essential needs. In fact, 78% of recipients spend a portion of their refund on housing and food, while 66% of individuals spend a portion of the refund on school supplies, clothing, and shoes[4]. Other expenses that recipients usually use their refund towards include utility bills and paying down debts.

Due to the impact of the COVID-19 pandemic on the California economy, and its disproportionate effects on lower-income earners[5], many recipients of CalEITC who rely on the refund they receive from the tax credit will be left with a much smaller refund or none at all.

Workers who were furloughed in 2020 will report a reduced income, while workers who were laid off will only report an income for part of the year; both will generate a reduced tax credit. This will result in recipients receiving less access to funds, which could be allocated for critical expenses related to housing, food, utilities, and PPE.

EXISTING LAW

Existing law allows for an earned income tax credit against personal income tax to be paid out from the Tax Relief and Refund Account for a credit that is in excess of the eligible individual's tax liability. The credit equals the portion of the earned income tax credit that is allowed by federal law as determined by the earned income tax credit adjustment factor.

The Taxpayer Certainty and Disaster Tax Relief Act of 2020 allows filers of the federal EITC program to elect either their 2019 or 2020 income when filing for the federal tax credit for the 2020 tax year.

THE SOLUTION

SB 276 would follow the precedent set by the IRS and allow filers of CalEITC to elect either their 2019 or 2020 earned income when filing for their 2020 California Earned Income Tax Credit (filed in 2021).

By authorizing taxpayers to elect either their 2019 or 2020 incomes, filers will be able to choose the income year that will provide them with the greater tax credit and, therefore, greater tax refund.

This allows individuals most affected economically by the COVID-19 pandemic during the 2020 tax year to continue to receive the assistance provided by the tax credit, without being further disadvantaged by the effects of a closed state and economy.

FOR MORE INFORMATION

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Bill text and status can be found at:
http://leginfo.legislature.ca.gov/

[1] https://www.ppic.org/blog/tag/social-safety-net-programs/
[2] https://www.ftb.ca.gov/forms/2020/2020-3514-instructions.html
[3] https://www.ppic.org/publication/earned-income-tax-credits-in-california/
[4] https://openscholarship.wustl.edu/cgi/viewcontent.cgi?article=1589&context=csd_research
[5] https://www.ppic.org/wp-content/uploads/incoming-inequality-and-economic-opportunity-in-california-december-2020.pdf

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