OAKLAND CITY COUNCIL

RESOLUTION NO. 80460 C.M.S.

INTRODUCED BY COUNCILMEMBER Nancy Nadel

RESOLUTION IN SUPPORT OF AB 21 (JONES) ESTABLISHING STATE EARNED INCOME TAX CREDIT (EITC)

WHEREAS, according to the California Budget Project, a non-profit advocacy organization, providing nonpartisan analyses of state fiscal and tax policies impacting all Californians especially low- and middle-income residents, over two million Californians live in families that are working, but poor, and an additional 1.4 million live in families that are literally just dollars above the poverty line; and

WHEREAS, the earnings from full-time minimum wage job fails to provide sufficient income to lift a family of three or more above the federal poverty line; and

WHEREAS, the Earned Income Tax Credit lifts more children and families out of poverty than any other social program; and

WHEREAS, 21 states already have their own Earned Income Tax Credit, including New York, Illinois, and New Jersey; and

WHEREAS, AB 21 (Jones) would create a statewide refundable tax credit for California families who currently receive the federal EITC; and

WHEREAS, in 1998, 2.4 million California households claimed $3.8 billion in federal EITC benefits; and

WHEREAS, during the 2006 tax season, the City of Oakland's Department of Human Services Community Action Partnership, in conjunction with the Alameda County Earned Income Tax Credit (EITC) Campaign and AARP, supported 20 free tax preparation sites throughout the City of Oakland. As a result, 5,702 federal tax returns were prepared during the 2006 campaign generating $4,688,572 back into the hands of Oakland's low-income families; and

WHEREAS, a statewide EITC would stimulate the economy by providing additional income to low-income working families and would work in tandem with the federal credit to boost the earnings that low income families receive from work; now therefore, be it

RESOLVED, that the City of Oakland declares its support for AB 21 (Jones) establishing a California state Earned Income Tax Credit; and be it further

RESOLVED, that the City Council directs the City Administrator and the City's legislative lobbyist to advocate for the above position in the State Legislature.

IN COUNCIL, OAKLAND, CALIFORNIA, MAR 20 2007, 20____

PASSED BY THE FOLLOWING VOTE:

AYES - BROOKS, BRUNNER, CHANG, KERNIGHAN, NADEL, QUAN, REID, and PRESIDENT DE LA FUENTE - 8

NOES - 0

ABSENT - 0

ABSTENTION - 0

ATTEST: LaTonda Simmons

LaTonda Simmons
City Clerk and Clerk of the Council
of the City of Oakland, California

CALIFORNIA BUDGET PROJECT

Budget Brief

March 2001

HOW CAN A STATE EARNED INCOME TAX CREDIT HELP CALIFORNIA'S WORKING POOR MAKE ENDS MEET?

Economic trends have made it harder for many families to make ends meet despite the presence of one or even two working parents. The prevalence of poverty among California's working families is striking. Over two million Californians live in families that are working, but poor, and an additional 1.4 million live in families hovering just above the poverty line.[1] Over a quarter (28.7 percent) of the California workforce earned poverty level wages in 1999, up from 24.0 percent a decade before.[2] In California, the earnings from full-time minimum wage work fail to provide sufficient income to lift a family of three or more above the federal poverty line. In previous decades, economic growth could be relied upon to produce rising incomes. More recently, families at the lower end of the wage scale, particularly those supported by earners without a college education, have seen the purchasing power of their wages decline and have experienced diminished prospects of moving up the economic ladder.

One of the most powerful tools available to boost the incomes of the working poor is the federal Earned Income Tax Credit (EITC). In 1998, 2.4 million California households, one out of every six tax returns filed, claimed $3.8 billion in federal EITC benefits.[3] An EITC works by using the tax system to target cash assistance to low income households with earnings from work. The amount of assistance provided by the credit is based on a family's size and its income. Fourteen states and the District of Columbia - Colorado, Illinois, Iowa, Kansas, Maryland, Maine, Massachusetts, Minnesota, New Jersey, New York, Oregon, Rhode Island, Wisconsin, and Vermont - currently have state Earned Income Tax Credits that complement the federal credit and boost the incomes of the working poor. Nine states - Colorado, Kansas, Maryland, Massachusetts, Minnesota, New Jersey, New York, Wisconsin, and Vermont - and the District of Columbia have refundable credits.

Recent attention to the growth in the number of California's families who are working, but poor, has increased interest in proposals to enact a state EITC. This paper explores the feasibility of using a state EITC to further supplement the earnings of low income working families.

How Does the Federal Earned Income Tax Credit Work?

Eligibility for the federal EITC is limited to low income families and individuals with earnings from work. The amount of credit available depends on family size and income. The credit varies with income in three ranges: (1) the phase-in range where EITC benefits increase with earnings; (2) a plateau where the maximum EITC amount remains constant; and (3) the phase-out range where benefits decline as earnings increase (Figure 1). In 2000, a family with two or more dependents is eligible for a maximum EITC of $3,888. The credit declines as household income rises above $12,690, with an eligibility cap of $31,152. A family with one dependent is eligible for a maximum credit of $2,353, with an income cap of $27,413. The EITC provides a maximum credit of $353 for childless workers at least 25 years of age, based on their share of payroll taxes - 7.65 percent - with an income limit of $10,380.[4]

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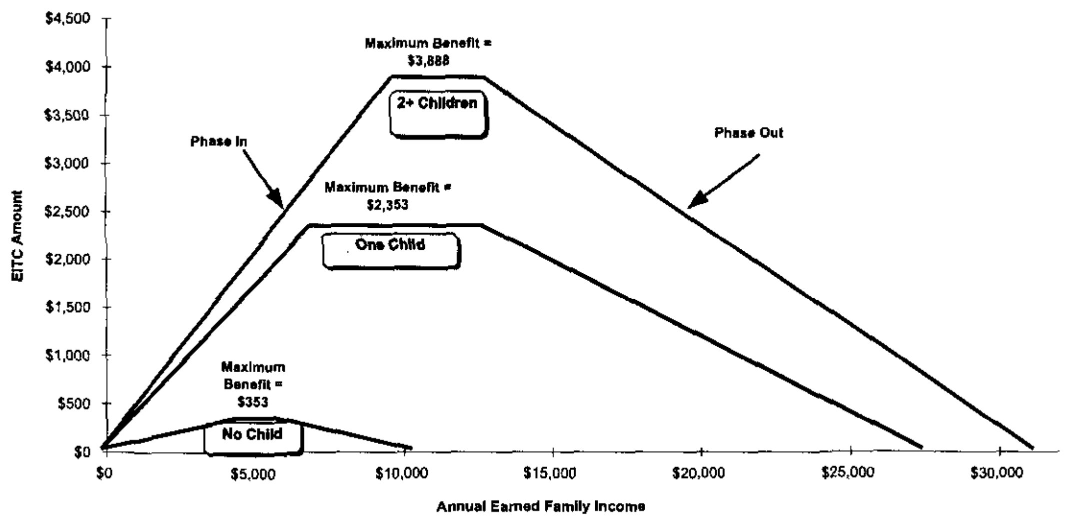
Figure 1
Federal Earned Income Tax Credit for 2000 Tax Year



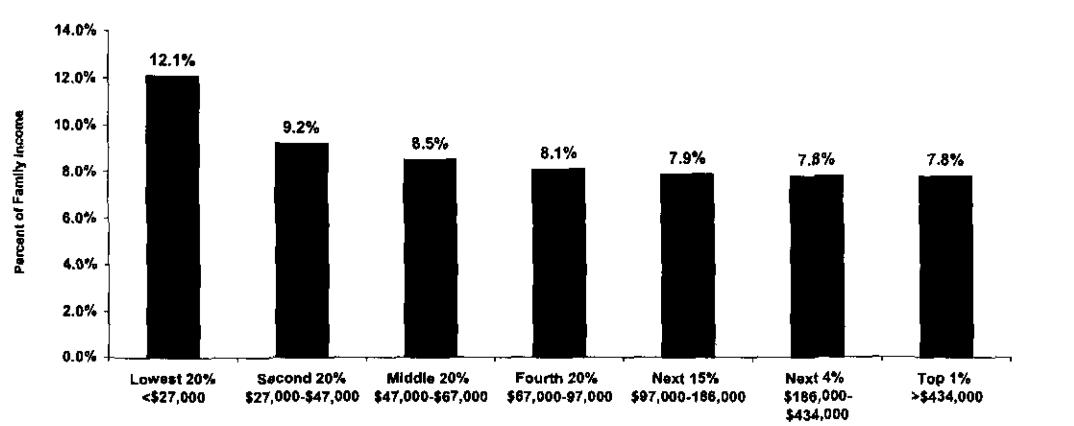
Most families claim their EITC when they file their federal income tax return. A small number of families choose to receive the credit throughout the year as a supplement to their paycheck through the advance payment option.

How Would A State Earned Income Tax Credit Work?

Most state EITCs are patterned after the federal credit. By linking state eligibility rules to those of the federal credit, California can take advantage of federal compliance efforts and coordinated efforts to publicize the availability of the credit so that families receive the benefits for which they are eligible.

Refundability is a key feature of the EITC. Refundable tax credits are paid to families regardless of whether or not they owe income tax. The EITC is first used to reduce a family's tax liability, with any

Figure 2
Low Income Families Pay A Larger Share of Their Income in California State and Local Taxes (1998)



Note: Calculated for non-elderly, married couples. Reflects federal deductibility of state taxes.
Source: Institute on Taxation & Economic Policy Microsimulation Tax Model, April 1998.

remainder returned to the family in the form of a refund. For California, refundability is particularly critical since the state's personal income tax threshold — the income level at which families begin to owe taxes — is so high. A married couple with two children will have no 2000 state income tax liability unless their income exceeded $39,790, while a single mother with one child would not pay state income taxes unless she earned in excess of $32,041.[5] Thus a nonrefundable credit would provide minimal or no relief to most California families that qualify for the federal EITC. While lower income California families have no income tax liability, they do pay payroll, sales, and excise taxes. In fact, the lowest income 20 percent of California families pay a greater share of their income in the form of California state and local taxes than do any other income group (Figure 2).

What Would A State EITC Mean for California Families?

A state EITC would work in tandem with the federal credit to boost the earnings that low income families receive from work. The income of a family of three supported by a full-time minimum wage worker still falls below the poverty level, despite the recent increase in California's minimum wage to $6.25 per hour. The same family would be raised out of poverty by the combination of a state and federal EITC (Table 1). A state credit equal to 15 percent of the federal credit, for example, would provide a maximum of $583 per year to a family with more than one child and up to $353 per year for a family with one child.

Table 1: How Would A State Earned Income Tax Credit Help A Family Supported by A Low Wage Earner? (for a wage earning family with two children)

	Gross Earnings	Percent of 2001 Poverty Guideline	Federal EITC	State EITC Equal to 15% of Federal Credit	Total	Percent of 2001 Poverty Guideline
Family of Four Supported by:						
Full-time minimum wage work	$13,000	74%	$3,817	$ 573	$17,390	99%
Earnings equivalent to the federal poverty line	$17,650	100%	$2,838	$426	$20,914	118%
Two full-time minimum wage workers	$26,000	147%	$1,080	$162	$27,242	154%
Family of Three Supported by:						
Full-time minimum wage work	$13,000	89%	$3,817	$573	$17,390	119%
Earnings equivalent to the federal poverty line	$14,630	100%	$3,480	$522	$18,632	127%
Full-time work at 150% of the minimum wage	$19,500	133%	$2,449	$367	$22,316	153%

How Do Families Use Their EITC?

Families that claim the EITC use it to make major purchases, including investments in education and housing that can help boost their families economic well-being. One study found that over half of the families surveyed purchased furniture or appliances, with a sizeable fraction using their credit to purchase a car or save for a downpayment on a home.[6] Other researchers found that paying outstanding bills accounted for the most prevalent use of families' EITC, while approximately one out of six use the money they received for tuition or other education related expenses.[7] Both groups of researchers found that many families save at least a portion of their credit for major investments or emergencies.

How Much Would A State Earned Income Tax Credit Cost?

Because of the large number of California's working poor, the cost of implementing a state EITC is significant. A state credit equal to 15 percent of the federal credit would cost an estimated $605 million in 2000-01. Almost all of the benefits of the credit would accrue to taxpayers in the form of a refund. A smaller credit would reduce the cost to the state, while a larger credit would provide additional assistance (Table 2).

Table 2: How Much Would A State Earned Income Tax Credit Cost?

Size of State Credit (% of Federal EITC)	Cost of Credit (2001-02, in millions)	Average Credit*	Maximum Credit One Child (2000)	Maximum Credit More Than One Child (2000)
10%	$404	$160	$235	$389
15%	$605	$240	$353	$583
20%	$806	$320	$471	$778

* Based on 1998 federal credits actually claimed

The EITC Helps Families Leave Welfare for Work

A number of studies suggest that the EITC has helped encourage single parents to leave welfare and enter the workforce. UCLA Researcher Joseph Hotz and his colleagues found that the expansion of the federal EITC could account for a sizeable fraction of the increased employment of California welfare recipients between 1993 and 1998.[8] Other researchers have found larger employment increases among single parents in states with state EITCs than in states without.[9]

Federal TANF Regulations Offer New Opportunities

On April 12, 1999, the Department of Health and Human Services (DHHS) released the final regulations implementing the federal Temporary Assistance for Needy Families (TANF) program. The regulations give states additional flexibility to tailor state welfare programs to meet the needs of low income families, including the ability to use federal TANF funds to support state EITCs. The new rule allows amounts spent on state refundable EITCs (and other refundable credits) to count toward states' MOE requirements. However, only the refunded portion of the credit (i.e. the amount that exceeds a family's tax liability) counts toward the MOE. If a credit only reduces a family's tax liability but the family still pays a positive tax bill, the amount of the reduction does not count toward the state's MOE requirement. Since nearly all of the cost of a California EITC is attributable to refunded credits, this provision is particularly significant. California carried over $491 million in unspent CalWORKs funds from the 1999-00 budget to 2000-01.[10] While some of these funds may be needed to meet basic program needs in the event of an economic downturn, a portion of the unspent balance could help finance a state EITC.

How Difficult Would A State EITC Be to Administer?

An EITC offers a relatively efficient and cost effective means of targeting assistance to low income working families. Estimates suggest that the cost of administering the federal credit is approximately one percent of the program's costs, extremely low compared to administrative costs of other income support programs such as CalWORKs and Food Stamps.[11] California's Franchise Tax Board previously administered a refundable renters' tax credit and a refundable child care credit was established as part of the 2000 budget agreement. Administrative costs attributable to the added workload of the renters' tax credit were less than one percent of the total cost of the credit.[12]

Recent changes to the federal EITC have helped ensure that the credit is only claimed by eligible families. In previous years, reports suggested that significant numbers of taxpayers erroneously claimed the EITC. In response to this criticism, the IRS now requires taxpayers to submit Social Security numbers for all parents and children claiming eligibility for the credit; imposes strict scrutiny of returns filed claiming the EITC; and has changed the rules which allowed taxpayers to claim the refundable portion of the EITC as a "rapid refund." These steps have greatly reduced error rates and fraud once associated with the EITC.

Would the Working Poor Benefit More by A Reduction in Tax Rates?

As an alternative to an EITC, some propose increasing the "zero bracket" amount (the level at which income first becomes subject to tax) or reducing the tax rate on earnings of low income families. California's tax threshold – the income level at which families are subject to tax – is the highest in the nation. As discussed above, the lowest income working families already pay no state income tax as a result of California's progressive rate structure, personal and dependent tax credits, and standard deduction. A married couple with two children would have no state income tax liability unless they earned more than $39,790 in 2000 – 233 percent of the federal poverty threshold. Families with incomes below the zero bracket amount would receive no benefits from a reduction in tax rates. Only those families with incomes between the current zero bracket level and a new, higher zero bracket would benefit from a change that increased the income level at which a family became subject to taxation. While changes of this type would provide relief for some lower income households, they would not help the millions of working families whose incomes are already so low as to have no tax liability.

Conclusion

A state EITC would help California's working poor move toward self-sufficiency and would provide needed tax relief to the low income families who experience the heaviest burden from state and local taxes. Research findings suggest that the EITC can play a powerful role in helping families leave welfare for work and make major purchases that can boost their long-term economic well-being. As one component of a comprehensive anti-poverty strategy, a state EITC provides a means to successfully boost the income of millions of low income California workers by building on a federal program that has a history of strong bipartisan support.

The California Budget Project (CBP) was founded in 1994 to provide Californians with a source of timely, objective, and accessible expertise on state fiscal and economic policy issues. The CBP engages in independent fiscal and policy analysis and public education with the goal of improving public policies affecting the economic and social well-being of low and middle income Californians. Publication of this Brief was supported by grants from The Rosenberg, Ford, Charles Stewart Mott, and Friedman Family Foundations. Support for the CBP comes from foundation grants, publications, and individual contributions. Jean Ross prepared this Brief. Please visit the CBP's web site at www.cbp.org.

BILL NUMBER: AB 21 INTRODUCED
BILL TEXT

INTRODUCED BY Assembly Member Jones

DECEMBER 4, 2006

An act to add Section 17052.1 to the Revenue and Taxation Code, relating to taxation, to take effect immediately, tax levy.

LEGISLATIVE COUNSEL'S DIGEST

AB 21, as introduced, Jones. Income taxes: earned income tax credit.
The Personal Income Tax Law authorizes various credits against the taxes imposed by that law, including certain credits that are allowed in modified conformity to credits allowed by federal income tax laws.
This bill would, for taxable years beginning on or after January 1, 2008, allow a credit computed by multiplying the federal credit amount, as defined, by 15% and subtracting therefrom the alternative minimum tax, as specified. The credit would be refundable upon appropriation by the Legislature, as provided.
This bill would take effect immediately as a tax levy.
Vote: majority. Appropriation: no. Fiscal committee: yes. State-mandated local program: no.

THE PEOPLE OF THE STATE OF CALIFORNIA DO ENACT AS FOLLOWS:

SECTION 1. Section 17052.1 is added to the Revenue and Taxation Code, to read:
17052.1. (a) For each taxable year beginning on or after January 1, 2008, there shall be allowed as a credit against the "net tax" (as defined by Section 17039) an amount determined under subdivision (b).
(b) Except as otherwise provided in this section, the amount of the credit allowed under subdivision (a) shall be computed by multiplying the "federal credit amount" (as defined in subdivision (c)) by 15 percent and subtracting therefrom the amount of tax imposed by Section 17062 (relating to alternative minimum tax), if any, for the same taxable year.
(c) The term "federal credit amount" means the amount determined under Section 32 of the Internal Revenue Code prior to the application of subdivision (h) of that section, relating to reduction of credit to taxpayers subject to alternative minimum tax.
(d) No credit shall be allowed under this section to any of the following:
(1) Any person who is treated as a nonresident for any portion of the taxable year.
(2) Any person who is married (within the meaning of Section 17021.5) and files a separate return for the taxable year.
(e) Section 3507 of the Internal Revenue Code, relating to advance payment of earned income credit, shall not apply.
(f) For purposes of this section, any reference to Section 32 of the Internal Revenue Code means the Internal Revenue Code as amended by Public Law 106-107.

(g) If the amount allowable as a credit under this section exceeds the tax liability computed under this part, the excess shall be credited against other amounts due, if any, and the balance, if any, shall be refunded to the taxpayer upon appropriation by the Legislature.

(h) Notwithstanding any other state law, and to the extent permitted by federal law, amounts refunded pursuant to subdivision (g) shall be treated the same as the federal credit defined in subdivision (c) for the purpose of determining eligibility to receive benefits under Division 9 (commencing with Section 10000) of the Welfare and Institutions Code or amounts of those benefits.

SEC. 2. It is the intent of the Legislature that state funds spent for the purposes of an earned income tax credit shall be balanced by a commensurate increase in state revenues realized from the closure of loopholes in the Revenue and Taxation Code and from the repeal or modification of outmoded, ineffective, or unfair tax expenditures.

SEC. 3. This act provides for a tax levy within the meaning of Article IV of the Constitution and shall go into immediate effect.