
UNFINISHED BUSINESS

Bill No: SB 565
Author: Caballero (D), et al.
Amended: 9/8/23
Vote: 21

SENATE GOVERNANCE & FIN. COMMITTEE: 6-1, 4/26/23
AYES: Caballero, Blakespear, Durazo, Glazer, Skinner, Wiener
NOES: Dahle
NO VOTE RECORDED: Seyarto

SENATE APPROPRIATIONS COMMITTEE: 5-2, 5/18/23
AYES: Portantino, Ashby, Bradford, Wahab, Wiener
NOES: Jones, Seyarto

SENATE FLOOR: 32-6, 5/24/23
AYES: Allen, Alvarado-Gil, Archuleta, Ashby, Atkins, Becker, Blakespear,
Bradford, Caballero, Cortese, Dodd, Durazo, Eggman, Glazer, Gonzalez,
Hurtado, Laird, Limón, McGuire, Menjivar, Min, Newman, Padilla, Portantino,
Roth, Rubio, Skinner, Smallwood-Cuevas, Stern, Umberg, Wahab, Wiener
NOES: Dahle, Grove, Jones, Niello, Ochoa Bogh, Seyarto
NO VOTE RECORDED: Nguyen, Wilk

ASSEMBLY FLOOR: Not available

SUBJECT: Taxation: filing

SOURCE: Author

DIGEST: This bill requires the Franchise Tax Board to provide a free tax return preparation program to qualified individuals.

Assembly Amendments (1) sunset this bill on December 1, 2031, (2) make technical changes, including to reflect the enactment of SB 131 (Committee on Budget & Fiscal Review, Chapter 55, Statutes of 2023) which amended the same code section as this bill, and (3) resolve conflicts with AB 1002 (Irwin).

ANALYSIS:

Existing law:

- 1) Requires the Franchise Tax Board (FTB) to develop and make available forms for taxpayers that are as simple as possible for taxpayers to prepare; FTB must ease taxpayers' compliance burden in the form and design of tax returns.
- 2) Enacts a refundable Earned Income Tax Credit against the Personal Income Tax, in modified conformity with federal law (SB 80, Committee on Budget and Fiscal Review, Chapter 51, Statutes of 2015).
- 3) Provides that the EITC is only operative for taxable years for which resources are authorized in the annual Budget Act for FTB to oversee and audit returns associated with the credit.
- 4) Provides that the Legislature must establish the California EITC adjustment factor – the percentage of the credit allowed for federal taxes for the taxpayer - for each taxable year; otherwise the California EITC adjustment factor is zero. For 2022, the California EITC adjustment factor is 85 percent, with the actual amount of EITC allowed dependent upon filing status of the eligible individual, how many qualifying children the eligible individual has, and how much earned income the eligible individual claims.
- 5) Allows, additionally, a refundable Young Child Tax Credit (YCTC) for a taxpayer who claims the EITC, and who has a child under the age of 6 at the end of the taxable year, equal to \$1,000, which is reduced by \$20 for each \$100 (or fraction thereof) that the taxpayer's income exceeds \$25,000.
- 6) Allows, additionally, a Foster Youth Tax Credit (FTYC) of up to \$1,083 per eligible individual, who meets all of the following requirements:
 - a) Qualify for the CalEITC;
 - b) Were between the ages of 18 and 25 at the end of the taxable year;
 - c) Were in California foster care at age 13 or older and placed through the California foster care system; and
 - d) Satisfy the foster care verification requirement.
- 7) Allows individuals with income below a certain threshold to not file a tax return for state purposes, when the value of the standard deduction and personal exemption credit exceed the taxpayer's liability. For 2022, these

thresholds are \$20,913 in gross income or \$16,730 in adjusted gross income (AGI) for single taxpayers (under 65 years of age with no dependents) and \$41,830 in gross income or \$33,466 in AGI for married individuals filing jointly (under 65 years of age with no dependents).

- 8) Increases the above thresholds based on the number of dependents claimed, or if the taxpayer(s) are over the age of 65, and directs FTB to adjust them annually for inflation.
- 9) Prohibits, generally, disclosure or inspection of any income tax return information, and sets forth criminal sanctions, including imprisonment, which apply to FTB personnel convicted of unlawful disclosure or inspection of tax records.
- 10) Contains explicit exemptions allowing FTB to disclose information to certain entities for specified purposes, including to allow FTB to exchange data with the Department of Social Services (DSS) and the Department of Health Care Services (DHCS) including the names, addresses, and contact information of individuals that may qualify for the EITC.

This bill:

- 1) Requires FTB to provide a free tax return preparation program to qualified individuals for taxable years beginning on or after January 1, 2025, and ending after the 2030 taxable year.
- 2) Specifies that for taxable years that begin on or after January 1, 2025, and before January 1, 2027, the program must be made available to qualified individuals that file as single with no dependents or married filing separate.
- 3) Requires FTB to expand the program to include all qualified individuals no later than taxable years beginning on or after January 1, 2027, and ending after the 2030 taxable year.
- 4) Defines “free tax return preparation program” as a free program that utilized pre-population of data (to the extent possible) for qualified individuals to complete and e-file their California state personal income tax returns.
- 5) Defines “CalFile” as the FTB’s free, direct, online program for taxpayers to complete and e-file their California state personal income tax returns.
- 6) Defines a “qualified individual” as a natural person that meets all of the following requirements:

- a) Has filed individual income tax returns for at least one of the five prior taxable years prior to the calendar year that the individual uses the free tax return preparation program;
 - b) Has received an invitation from the FTB to participate in the free tax return preparation program for the taxable year;
 - c) Is eligible to use CalFile for the taxable year; and
 - d) Is eligible for any of the following credits:
 - i) CalEITC
 - ii) YCTC
 - iii) FYTC
- 7) Requires that the free tax return preparation program shall meet the following requirements:
- a) Provides questions to guide qualified individuals to file their California income tax returns; and
 - b) Allows taxpayers to edit or correct the information on their return prior to filing include their filing status and information on their dependents.
- 8) Exempts the FTB from all provisions of state contracting law and any approvals or oversight from the Department of Technology or the Department of General Services, as well as from Project Approval Lifecycle requirements and reporting as described in the applicable sections of the Statewide Information Management Manual, for purposes of implementing the bill.
- 9) Specifies that the free tax return preparation program shall be available for use beginning on January 20, 2026.
- 10) Expands existing data sharing provision between the DSS, the DHCS, and the FTB, to allow for the exchange of data directly connected with the administration of the free tax return preparation program established under Section 19587 that would be added by this bill.
- 11) Repeals the measure on December 1, 2031.
- 12) Contains provisions to resolve conflicts with AB 1002 (Irwin).

Background

Increasing EITC claims. Since it was enacted, taxpayers were not claiming the California EITC at the Legislature’s desired and anticipated rate. In 2020, the Legislature enacted SB 1409 (Caballero, Chapter 114, Statutes of 2020), which requires the FTB provide a study that would analyze and develop a plan to implement a “no return” or “non-filer” tax filing pilot program. The study was provided to the legislature on January 3, 2022. The findings discussed opportunities to allow for taxpayers with little to no income to file their returns to claim the CalEITC, YCTC and FYTC. The study discussed each possibility, and indicated that there would be less risk if FTB were able to work with “known populations” of taxpayers first, before they did any outreach to those without a filing requirement who have never filed with the FTB. The study recommended enhancing CalFile as a starting point would allow the FTB to reach out to those that have filed with the FTB in the past. The report noted that there were significant fraud risks in starting with the simplified one page return and not starting with a known population of taxpayers

CalFile. CalFile is a free, direct online program that allows taxpayers to e-file their California only personal income tax returns with FTB. The CalFile program expanded the taxpayer population eligible for this service and also allowed taxpayers to file prior year returns. FTB began utilizing CalFile exclusively as a simplified filing portal for the California return in 2015. This portal also allowed for pre-population of data if taxpayers registered and obtained a MyFTB account. However, this portal does not provide a mechanism for the taxpayer to file a federal personal income tax return.

Related/Prior Legislation

AB 1002 (Irwin, 2023) directs FTB, for taxable years beginning on or after January 1, 2026, to allow a qualified individual, who cannot claim withholding or other credits, to claim the EITC, the YCTC, or the FYTC on a form that does not require the qualified individual to file an individual income tax return. The bill also allows the FTB to develop a smaller form that may be filed in its place. The bill also exempts the FTB from existing contracting laws and specified approvals and oversight in administration relating to the form. AB 1002 is currently pending on the Senate Floor.

FISCAL EFFECT: Appropriation: No Fiscal Com.: Yes Local: No

According to the Assembly Appropriations Committee:

- Costs of approximately \$609,000 in fiscal year (FY) 2023-24, \$4.1 million in FY 2024-25, and \$7 million in FY 2025-26 to FTB to develop the program and update information technology (IT) systems (General Fund (GF)). FTB notes this cost estimate was developed with the assumption that another bill (AB 1002 (Irwin)) requiring FTB to facilitate CalEITC, YCTC, and FYTC claims is also enacted, as the resources and system changes needed for both proposals are significantly intertwined. Thus, costs associated with this bill may be higher if AB 1002 is not also enacted.
- Likely minor and absorbable costs to DSS and DHCS to exchange data with FTB, as the agencies are already required exchange data with FTB to implement other tax programs.
- GF revenue loss of an unknown, but potentially significant, amount to the extent streamlining the tax filing process increases the number of taxpayers claiming the CalEITC, YCTC, or FYTC.

SUPPORT: (Verified 9/12/23)

All Home

Economic Security Project Action

OPPOSITION: (Verified 9/12/23)

California Taxpayers Association

ARGUMENTS IN SUPPORT: According to the author, “The California Earned Income Tax Credit, Young Child Tax Credit, and Foster Youth Tax Credit are some of California’s most important anti-poverty tools, which improve the economic security of working families that struggle to make ends meet. California has made important investments in educational outreach to ensure eligible families are aware that they qualify for these credits, but many still fail to claim the credits because they do not file a state tax return. SB 565 implements recommendations by the FTB pursuant to SB 1409 (Caballero, 2020) to reduce barriers to tax filing by requiring FTB implement new enhancements to the CalFile program. CalFile is a free to use tax filing system for eligible households, but due to a variety of factors, can be cumbersome and is not user friendly. Under SB 565, FTB will be required to modify CalFile to enhance the user experience and notify taxpayers of their eligibility to file, including when data can be pre-populated automatically. SB 565

will not only improve an existing platform for tax filers, it will help ensure more eligible families receive the credits they are entitled to.”

ARGUMENTS IN OPPOSITION: According to the California Taxpayers Association, “The program proposed under SB 565 could lead to potential conflicts of interest, as the FTB would be responsible for partially filing, processing, reviewing, and adjudicating tax returns. When a taxpayer engages in filing on their own behalf or through a tax preparer, the taxpayer or the preparer will be able to advocate in the taxpayer’s interest. There must be a separation between the taxpayer and tax administrator/collector to maintain fairness and objectivity during the compliance process. SB 565 could result in taxpayers receiving less tax credits than they are eligible to receive, or possibly exposing the FTB to potential fraudulent claims. Assessing eligibility for tax credits is a complicated process that requires intimate knowledge about taxpayers’ families and living situations, in addition to income, age, and other factors that might be relevant for a particular credit. Errors could cause interruptions or delays in receiving benefits, and fraudulent claims would undermine the integrity of the tax credit programs. Errors also could lead to filers receiving lower benefits than they are eligible for, or overstatements of credits that the recipient would have to pay back (with interest and penalties). Further, a pre-populated state return may result in taxpayers missing out on federal credits they are eligible to claim, since filing both a state and federal return is necessary to claim federal credits.”

Prepared by: Colin Grinnell / GOV. & F. / (916) 651-4119
9/13/23 20:38:11

**** END ****