



May 9, 2017

The Honorable Holly J. Mitchell  
 Chair, Budget and Fiscal Review Committee  
 California State Senate  
 Sacramento, CA 95814

The Honorable Phil Ting  
 Chair, Budget Committee  
 California State Assembly  
 Sacramento, CA 95814

**RE: Strengthening and Expanding the California Earned Income Tax Credit (CalEITC)**

Dear Senator Mitchell and Assemblymember Ting:

Our organizations write to strongly support the California Earned Income Tax Credit (CalEITC) and urge you to strengthen and expand the credit in the 2017-18 state budget to provide an income boost to more working families living in poverty by: 1) investing in outreach and free tax preparation so more eligible families receive their credits; 2) enabling all self-employed workers meeting the income eligibility requirements to benefit; and 3) increasing the CalEITC income eligibility threshold.

The CalEITC, enacted by the Legislature and the Governor in 2015, provides much-needed assistance to working families and individuals who are struggling to make ends meet. The CalEITC has long-lasting benefits for children, families, and communities. The CalEITC:

- **Reduces deep poverty:** More than 1 in 5 Californians – including nearly 1 in 4 California children – live in poverty. The state’s poverty crisis leaves millions of working Californians unable to meet basic needs. The CalEITC builds upon the success of the federal EITC, which is the nation’s largest and most successful anti-poverty program.

The CalEITC lifts 23,000 California families out of deep poverty, according to the Franchise Tax Board.

- **Improves child and maternal health:** Research on the EITC shows the income boost improves maternal health and reduces the likelihood of low-weight or premature births.
- **Promotes educational success:** Children receiving the EITC also tend to do better academically in both the short and long term, with higher test scores, higher high-school graduation rates, and higher college attendance rates.
- **Spurs local economic growth:** The EITC puts money in the hands of people most likely to spend it, which stimulates the local economy. Studies of EITCs adopted in other states have estimated that each additional dollar received by a tax filer can generate a further \$1.50-2.00 in local economic activity.
- **Builds economic security in the long run:** The benefits of the EITC extend to the next generation by increasing earnings when children reach adulthood.

### **Background on CalEITC**

The CalEITC is a refundable state tax credit that increases the economic security of working families. The credit is currently available to households with annual earnings below \$6,717 for an adult without qualifying children, \$10,087 for a family with one qualifying child or \$14,161 for a family with two or more qualifying children. In its first year, more than 385,000 working poor households benefited from the credit. The CalEITC primarily benefits working families with children, who can receive as much as \$2,706 from the CalEITC, in addition to the income boost they receive from the federal EITC. In 2016, families with children received an average of around \$830 from the CalEITC. The CalEITC is making a meaningful impact on families in deep poverty: many families used the credit to pay for food, rent, childcare and other basic needs, or one-time expenses such as a car repair to enable them to get to work.

When the CalEITC was passed in the 2015-16 budget, the Administration assumed \$380 million in tax expenditures to benefit an estimated 600,000 households. In the first year of implementation, the CalEITC reached fewer households than originally estimated and reduced personal income tax revenue by just \$295 million. The Administration's 2017-18 budget proposal reflects a \$264 million in tax expenditures, substantially less than the \$380 million originally assumed. Although the estimated "cost" of the credit has been reduced, the Administration has not proposed to increase the size of the credit or extend it to additional low-income workers. The 2017-18 budget proposal does identify CalEITC as one of the four "most significant accomplishments of the past four years."

We appreciate that the Legislature indicated in 2015-16 budget bill their intent to expand the CalEITC "to include a broader section of working poor Californians." Building on the success of the credit in its first year, we recommend that the CalEITC be strengthened and expanded to maximize its effectiveness as a poverty-fighting tool, work incentive, and driver of economic activity.

## **Recommended Improvements to the CalEITC in the 2017-18 Budget**

### **Invest in CalEITC outreach and free tax preparation services**

Promoting the CalEITC is critical to its success. The CalEITC targets very poor households, a hard to reach population who are struggling to make ends meet every day and are mostly not required to file state taxes unless they want to claim their credit. A survey conducted by the California Budget and Policy Center found that fewer than 1 in 5 people who were likely eligible for the CalEITC had even heard of the credit. The Franchise Tax Board acknowledged that households will churn on and off the income eligibility threshold for CalEITC, thereby making ongoing outreach efforts particularly important. Efforts to raise awareness of the CalEITC are critical to ensuring as many eligible families as possible benefit from the credit.

Promoting the state EITC also provides a great opportunity to increase participation in the federal EITC, which would draw millions of dollars into the state, help low-income working families better support themselves, and boost local economies.

The final 2016-17 budget included \$2 million to support CalEITC outreach and marketing. Unfortunately, no ongoing funds for outreach were included in the Governor's 2017-18 budget proposal.

California should fund robust outreach and increased capacity in free tax-preparation services throughout the state by continuing the CalEITC Education and Outreach Grant Program administered by the Department of Community Services and Development at a funding level of \$9 million to ensure outreach resources are sufficient to meet the needs and that free tax prep assistance is there for those who want to access it.

### **Include self-employment earnings in determining eligibility for the CalEITC**

Self-employment income is not currently counted in determining eligibility for the CalEITC. Neither the federal government nor any other state specifically exclude self-employed workers and entrepreneurs from claiming an earned income tax credit. California's decision to exclude self-employment income was made, according to statements made by the Governor's office, to prevent fraud. However, improper EITC payments mostly result from error, not intentional fraud. In addition, the difficulty with verifying self-employment income extends across the income spectrum and self-employed individuals are not disqualified from receiving other tax benefits solely because they have self-employment income. There is no justification for exclusively penalizing Californians in deep poverty who are trying to create their own jobs.

Therefore, the CalEITC should include self-employment earnings to reward work by entrepreneurs and independent contractors. According to budget simulations done by the Institute of Taxation and Economic Policy (ITEP) for the California Budget and Policy Center, this change would benefit an additional 134,000 low-income households at a cost of no more than \$40 million.

**Increase the CalEITC income eligibility threshold to reach all households eligible for the federal EITC**

Currently, many workers who struggle to make ends meet do not qualify for the CalEITC. Parents with one child cannot qualify if their earnings exceed about \$10,000, just half of a full-time minimum wage salary, and parents with two children cannot qualify if they earn more than about \$14,000. Without a change to adjust CalEITC eligibility levels with the minimum wage, fewer workers will be eligible for the CalEITC over time as the minimum wage increases.

The CalEITC income eligibility threshold should be increased to align with the federal EITC, which would make the credit available to an additional 2.7 million households at an estimated cost of \$1.7 billion. Extending the CalEITC to workers with higher incomes would enable the credit to lift working families above the poverty line and provide a more valuable work incentive to part-time employees and new workers entering the labor force.

While expanding eligibility for the credit to more households, the state should ensure that the very poor households currently eligible for the CalEITC continue to receive at least the same credit amount even as CalEITC eligibility expands and the minimum wage increases.

Thank you for your leadership on behalf of low-income families in California. We look forward to working with you to improve the CalEITC and advance towards a future where no Californian lives in poverty, especially working families. For further information, please contact Michele Stillwell-Parvensky at (510) 663-1294 or [msp@childrensdefense.org](mailto:mSP@childrensdefense.org) or Judy Darnell at [jdarnell@unitedwaysca.org](mailto:jdarnell@unitedwaysca.org).

Sincerely,

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