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DECEMBER 2007

Effective January 1, 2008, all employers covered under the California Unemployment Insurance Code are required to provide all employees with a special notice of their possible eligibility to take advantage of the federal Earned Income Tax Credits (EITC or EIC). There are logistical issues that employers need to consider when complying with the new laws requirement that the notice be either hand-delivered or mailed within one week of the date of sending to employees the annual wage summary (IRS Form W-2).

## California Edition

*A Littler Mendelson California-specific Newsletter*

### Special Earned Income Tax Credit Notices Must Be Sent to California Employees Beginning January 2008

*By GJ Stillson MacDonnell*

Effective January 1, 2008, a new California law (AB 650) requires that employers with employees covered under California Unemployment Insurance Code provide all such employees a special notice of their possible eligibility to take advantage of the federal Earned Income Tax Credit (EITC or EIC). The notice is to be either hand-delivered or mailed within one week of the date the annual wage summary (IRS Form W-2) is sent to employees.

#### EITC/EIC Facts and Background

EITC/EIC is a federal tax credit that can reduce certain low income taxpayers' federal taxes and may result in a refund of federal taxes. Employees can get advances by signing up with their employer for the federal Advance Earned Income Credit (AEITC) program. Under AEITC an employee gets adjustments on withholding that typically increases net paychecks throughout the year. To participate in the program, an employee annually needs to complete and provide to the employer IRS Form W-5.

Existing Internal Revenue Service (IRS) regulations require that an employer annually notify certain employees, who have had no income tax withheld (but did not claim to be exempt), of their possible eligibility under EITC/EIC. IRS encourages the Notices also be sent to anyone whose wages are less than an annually adjusted level, which for 2008 is \$41,646 for joint filers with two or more children. IRS Notices must be

either hand-delivered or sent first-class mail to employees. They can be printed on the back of the employee's copy of an IRS Form W-2, separately sent as IRS Notice 797 ("Possible Federal Tax Refund Due") or as a written notice, verbatim equivalent. Employer notices must also be sent within one week of the date IRS Form W-2 is sent, which is on or before January 31. Failure of an employer to make requested Advance EIC payments to a qualifying employee will subject the employer to a penalty equal to the amount that should have been paid as a credit. There is also a penalty for failure to willfully provide the Notice.

#### Why Impose the California Notice Requirement?

Before 2007, two California bills to provide substantially the same type of notice as is required by AB 650 were vetoed as being duplicative of federal requirements or being an educational matter best left to the federal government by the current and immediate past governors. However, the California Franchise Tax Board (FTB) purportedly issued a study that showed that nearly 460,000 California families qualified for, but did not claim EIC credit in 2005. The legislature viewed this as an unacceptable loss of income to these state residents.

As the California legislation evolved, concerns were raised that one of the reasons so few applied was out of a fear that participation would adversely affect certain welfare benefits' eligibility. The Notice was modified to suggest receipt of

EIC would not diminish other benefits.

## Who Is Covered By this Notice Requirement?

All California employers who are subject to the California Unemployment Insurance Code are required to provide notice to their employees covered by California unemployment insurance program. On a practical level this should limit notices to be sent to those acknowledged employees for whom an employer pays California unemployment taxes on their wages. Because multi-state employers are required to only pay unemployment taxes in one state, the statutory definition should preclude sending notices to employees who are “based” for unemployment insurance tax purpose in other states. However, the law does not have a measuring point, so an employee who is on the California payroll for any part of the year, seems to also be subject to receiving notice even if when the notice is received the employee may have relocated outside the state. There was no practical discussion in the legislature history of these logistical issues.

## When Is the Law Effective?

The law becomes effective January 1, 2008. There is no grace period in the law nor is there one suggested in its legislative history. There was absolutely no consideration given in the legislative process to the potential magnitude of imposing on California employers this notice requirement on what is relatively short notice.

## How Is the Notice Distributed?

The Notice can either be hand-delivered or sent in the mail. Notice by posting or notice by distribution through office mail is not allowed as the primary method of distribution but is encouraged, expressly in the statute, to effectively get the word out.

## When Should the Notice Be Sent?

Notice can be sent at the same time as IRS Form W-2 or, if not, it needs to be sent

within one week before or after the date the annual W-2 form is sent, which is no later than January 31. Consolidation into one mailing with a W-2 form is unlikely to be practical, at least for the year 2008. Since employers typically do not wait until January 31 to send W-2's and may stagger the distribution of the form, the statute's timing requirement creates further logistics concern.

## Who Needs to Get the Notice?

The state notice, unlike the federal notice, is not limited only to those who could potentially qualify for EITC/EIC, but it must be sent to all California employees covered by unemployment insurance. The California Employment Development Department's (EDD) 2006 labor statistics report indicates that there were approximately 15.4 million jobs in California. Without regard to some of these jobs having heavy turnover, which may mean multiple W-2's issued to different employees sequencing through any one a job in any one year, the notice requirement appears to impose on California employers an obligation to print notices and envelopes that could involve potentially 31 million sheets of paper. And, if they are all mailed, over \$6 million in postage for sending such notices. All this effort to reach a population, according to the FTB, of those not taking advantage of this credit, of less than one half million.

## What Is the Required Form of the Notice?

While an employer can create its own notice, it must contain substantially the same language as the statutory language, so there is not much reason, other than to augment the statutory notice, to use anything other than the statutory language which reads as follows:

**BASED ON YOUR ANNUAL EARNINGS, YOU MAY BE ELIGIBLE TO RECEIVE THE EARNED INCOME TAX CREDIT FROM THE FEDERAL GOVERNMENT. THE EARNED INCOME TAX CREDIT IS A REFUNDABLE FEDERAL**

**INCOME TAX CREDIT FOR LOW-INCOME WORKING INDIVIDUALS AND FAMILIES. THE EARNED INCOME TAX CREDIT HAS NO EFFECT ON CERTAIN WELFARE BENEFITS. IN MOST CASES, EARNED INCOME TAX CREDIT PAYMENTS WILL NOT BE USED TO DETERMINE ELIGIBILITY FOR MEDICAID, SUPPLEMENTAL SECURITY INCOME, FOOD STAMPS, LOW-INCOME HOUSING OR MOST TEMPORARY ASSISTANCE FOR NEEDY FAMILY PAYMENTS. EVEN IF YOU DO NOT OWE FEDERAL TAXES, YOU MUST FILE A TAX RETURN TO RECEIVE THE EARNED INCOME TAX CREDIT. BE SURE TO FILL OUT THE EARNED INCOME TAX CREDIT FORM IN THE FEDERAL INCOME TAX RETURN BOOKLET. FOR INFORMATION REGARDING YOUR ELIGIBILITY TO RECEIVE THE EARNED INCOME TAX CREDIT, INCLUDING INFORMATION ON HOW TO OBTAIN THE IRS NOTICE 797 OR FORM W-5, OR ANY OTHER NECESSARY FORMS AND INSTRUCTIONS, CALL THE INTERNAL REVENUE SERVICE BY CALLING 1 800 829 3676 OR THROUGH ITS WEBSITE AT WWW.IRS.GOV.**

## Are There Other Requirements?

The statute also requires that every employer shall process, in accordance with federal law, Form W-5 for advance payments of the EITC/EIC upon the request of the employee. As this is already a requirement under federal law, this California requirement is duplicative.

## Are There Any Penalties For Non Compliance?

Unlike the federal law, which imposes a penalty on an employer for failure to pay a request advance or provide the federal notice, there is no express California penalty for either not processing the W-5 form

or sending out the California notice.

The California law also requires notice be sent within one week of sending an IRS Form 1099 to any employee. As customarily employees only receive W-2 forms, this is at very least, a curious requirement. IRS form 1099MISC need only be sent to nonemployees, such nonemployees are not otherwise eligible for unemployment insurance coverage. Nothing in the legislative history suggests that it was intended that this Notice be sent to nonemployees. Query, would a contractor later determined to be subsequently misclassified be entitled to notice? A more likely explanation for reference to IRS form 1099MISC, was that it is further evidence of both the legislatures lack of attention to implications of the statute and its lack of understanding of the practical consequences of its actions.

## Is California Alone Out There?

Three other states have requirements involving providing notices to employees of ETIC credits. First enacted was a 1991 Illinois law that limits a similar notice expressly only to those employees whose gross wages do not exceed the maximum amount that might qualify for the federal Earned Income Tax Credit Illinois (Public Act 87 598). Louisiana enacted a law in 2005 (SB 57), which also limits such notices to employees who also would qualify under the caps provided under federal law. The Louisiana law further provides that there is no liability for civil damages for failure to comply. Lastly, also in 2005, New Jersey enacted a law, which provided that notices be sent by employers to employees. However, such notices are also only to be sent to employees an employer knows or reasonably believes would be eligible for the federal credit based on the wages reported. There is no evidence that California was inspired by or considered the actions of these states.

## Recommendations

- Since January is rapidly approaching, it is recommended that:

- Employers check on whether or not they are currently paying California unemployment taxes for employees.
- As to such employees, identify when their W-2 forms are scheduled to be sent.
- Prepare the California statutory notice.
- Identify the method for conveying - hand delivery or US Mail (method may vary by location of employee).
- Schedule a mailing or personal distribution to all employees coincidental to the distribution of the 2007 W-2 forms.
- Work with payroll service to automate the notice process for 2009 W-2 distribution.
- Consider advising elected officials of the practical consequence of this law.

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