

SUMMARY ANALYSIS OF AMENDED BILL

Franchise Tax Board

Author: Alquist, et. al Analyst: Roger Lackey Bill Number: AB 1174

Related Bills: See Prior Analysis Telephone: 845-3627 Amended Date: 05-09-2001

Attorney: Patrick Kusiak Sponsor: Lt. Governor Cruz Bustamante

SUBJECT: Higher Education Tuition, Fees, and Related Expenses Refundable Credit

DEPARTMENT AMENDMENTS ACCEPTED. Amendments reflect suggestions of previous analysis of bill as introduced/amended _____.

AMENDMENTS IMPACT REVENUE. A new revenue estimate is provided.

AMENDMENTS DID NOT RESOLVE THE DEPARTMENT'S CONCERNS stated in the previous analysis of bill as amended April 2, 2001.

FURTHER AMENDMENTS NECESSARY.

DEPARTMENT POSITION CHANGED TO _____.

REMAINDER OF PREVIOUS ANALYSIS OF BILL AS AMENDED April 2, 2001, STILL APPLIES.

OTHER - See comments below.

SUMMARY

This bill would create a refundable tax credit for the costs of higher education.

SUMMARY OF AMENDMENT

The May 9, 2001, amendments:

- Revised the repeal date of the credit to December 1, 2007.
- Amended the meaning of "qualified taxpayer" to include a taxpayer's dependent.
- Added to the 150% taxable income limitation a requirement that the individual applied for a Cal Grant, met all the eligibility criteria for a Cal Grant, and was denied a Cal Grant due to a lack of available grants.
- Revised the meaning of "qualified educational institution" by referencing a specific section of the California Education Code.
- Limited the credit to either the taxpayer or the taxpayer's dependent, but not both.
- Added a requirement that the Franchise Tax Board report to the Legislature regarding the annual utilization of the credit allowed.

As a result of the May 9, 2001, amendments, additional implementation considerations have been identified. These concerns, along with the implementation and policy considerations identified in the department's analysis of the bill as amended April 2, 2001, are included below.

Board Position:

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Legislative Director

Date

Brian Putler

05/23/01

In addition, a new revenue estimate is provided.

Except for the discussion of this analysis, the analysis of the bill as amended April 2, 2001, still applies.

IMPLEMENTATION CONSIDERATIONS

This bill would require the Franchise Tax Board to report to the Legislature regarding the annual utilization of the credit. The report provides no deadline so the department would interpret the reporting requirement to mean the department would report to the Legislature once the information became available. It should be noted that return information from a tax year is not readily available for reporting purposes. For example, a credit claimed in the 2001 taxable year and reported on a taxpayer's tax return in April of 2002, would not be available for reporting purposes until at the earliest late 2002 (November/December).

The term "fees" is undefined. It is unclear whether the author intends "fees" to include only the fees for college units (actual courses) or if fees would include all other annual fees and costs that may be incurred while attending an educational institution. Such costs could include parking fees, student association fees, or club fees.

The bill specifies that a qualified taxpayer must have "taxable income" within 150% of the maximum limit set for obtaining an award from the Cal Grant Program. For income tax purposes, "taxable income" is adjusted gross income (AGI) minus either the standard deduction or the taxpayer's itemized deductions, whichever is higher. The department currently does not capture "taxable income" amounts. Capturing this information would have a significant impact on the department's programs and administrative costs.

The taxpayer may claim an aggregate credit of \$1,500 over four years, either consecutive or nonconsecutive. This limitation may be difficult to administer, particularly if the credit is claimed for nonconsecutive years. The department would be required to retain data regarding the amounts of credit claimed for years for which the statute of limitations would have expired.

The bill limits the credit to the taxpayer or the taxpayer's dependent, but not both. However, no rule is provided to determine which of the two should be allowed the credit or a mechanism to resolve disputes.

The California Student Aid Commission (Commission) would be required to forward the names of all individuals eligible for the credit to the department for verification. This provision would require the Commission to keep track of students who are denied awards and their income information. In addition, information regarding whether the student actually attended an educational institution would be required. It is unclear if the Commission would be able to provide this information. Since the Commission cannot be expected to have complete and accurate information on students who are ineligible, a more effective means of verifying the eligibility would be useful.

The Commission also would be required to forward the social security numbers of all individuals eligible for the credit to the department. However, the department does not capture the social security numbers of dependents; therefore, the department would not be able to use the social security numbers of dependents for verification purposes as the author intends.

The bill does not specify that the information the Commission provides to FTB be transmitted in any given media (e.g., magnetic tape or other machine-readable form) or in a form and manner agreed upon by FTB.

The bill specifies the amount of the credit cannot exceed an aggregate amount of \$1,500 per taxpayer. It is unclear how this limitation would affect the different filing statuses. For example, a married couple that files "married filing separate" could each claim the \$1,500 credit. Clarification on this issue is needed.

This bill would require regular appropriations by the Legislature to pay for the refundable portion of this credit. If sufficient funds were not appropriated to cover all of the refunds due, the department would suspend payment of the refunds until additional funds were appropriated. This delay would result in additional contacts to the department by refund recipients, which would likely increase departmental costs.

Since the proposed credit is refundable, the credit calculation would need to be shown in the payment section on all personal income tax (PIT) returns except the Form 540 2EZ. This would increase the PIT return Forms 540, 540NR, 540X, and potentially the 540A, by one page. This would result in a significant impact on FTB's operations and costs. Adding a page to these returns will slow the processing of the returns and require additional storage space. While the department would work within available space to the extent possible, leasing additional office and file storage space may be necessary.

TECHNICAL CONSIDERATIONS

The bill limits the credit to qualified taxpayers that are required to: 1) apply for a Cal Grant, 2) meet all eligibility criteria for such a grant, and 3) be denied a Cal Grant due to a lack of grants available. However, the bill retains inconsistent language that appears to extend the credit to taxpayers that are "otherwise ineligible" for a Cal Grant award. This language should be deleted to eliminate taxpayer confusion.

The bill, as amended, uses the terms "taxpayer" and "taxpayer's dependent" in ways that create some ambiguity regarding the author's intent which may have unintended consequences. For example, the bill, as amended, could be interpreted to apply the taxable income limitation by looking to the taxable income of the taxpayer's dependent. If this is not the author's intent, the bill should be amended to clarify the author's intent.

This bill would require the Student Aid Commission to forward names and social security numbers to the Franchise Tax Board for each calendar year including 2008. However, the credit is repealed December 1, 2007. As a result, the information forwarded for the 2008 calendar year would not be of use.

ECONOMIC IMPACT

Revenue Estimate

Based on the data and assumptions below, revenue losses are estimated as follows:

Estimated Revenue Impact*			
Taxable Years Beginning On or After January 1, 2001			
Enactment Assumed After June 30, 2001			
Fiscal Years			
(In Millions)			
	2001-2	2002-3	2003-4
Higher Education Credit	-\$105	-\$50	-\$50

* Rounded to the nearest \$5 million.

No adjustment was made for students receiving financial aid other than Cal Grants, such as full scholarships, etc., since the proposal is silent on this issue.

This analysis does not consider the possible changes in employment, personal income, or gross state product that could result from this measure.

Revenue Discussion

The impact of this bill would depend on the number of taxpayers qualified to claim the credit and the amount and nature of qualified fees and expenses allowed.

Due to a new Cal Grant program in 2001, historical information on the number of eligible nonrecipients in the same Cal Grant program is not available. Based on discussions with the California Student Aid Commission, it is projected that approximately 70,000 students will apply and be eligible for a Cal Grant in 2001 but be denied due to lack of grants available. These 70,000 students will be applying for a competitive Cal Grant, not the newly established entitlement Cal Grants. Students applying and qualifying for an entitlement grant will receive the grant; lack of grant funding will not be an issue. Included in the 70,000 students will be students currently attending a qualified institution. Generally beginning in 2000-1, graduating seniors will be eligible for the entitlement Cal Grants and not part of the competitive grant process. For 2002 and subsequent years, it is projected that approximately 35,000 competitive grant applicants will qualify for this credit. The projected 35,000 students will include new students no longer or never eligible for entitlement grants or continuing students who are newly eligible for a competitive Cal Grant or were previously eligible but did not apply.

For each category of students, based on the type of educational institution attended, projected school fees, and related housing expenses exceed the proposed \$1,500 per taxpayer credit limitation. Therefore, the total \$1,500 credit was applied in the first year for all projected eligible students.

The students qualifying for a competitive grant and being denied due to a lack of funds but not attending school, and eligible students failing to claim the proposed credit were excluded from the projected revenue loss computation.

Information from the California Student Aid Commission, the California Postsecondary Education Commission, the Association of Independent Colleges and Universities, and in-house sources were used in the development of this revenue estimate.

ARGUMENTS/POLICY CONCERNS

Historically, refundable credits, such as the former state renter's credit and the federal Earned Income Credit, have had significant problems with invalid and fraudulent returns. These problems are aggravated if a refund is made that is later determined to be fraudulent. In such cases, the refund commonly cannot be recovered. However, fraud concerns are reduced with this credit due to the narrow criteria for claiming the credit.

Credits generally are provided as a percentage of amounts paid or incurred. This bill would allow a 100% credit, which is unprecedented.

The credit is limited to an aggregate total of \$1,500 per taxpayer, regardless of the number of dependents of that taxpayer attending qualified educational institutions.

Basing the allowance of the credit upon the taxable income of the taxpayer rather than the AGI of the taxpayer would put taxpayers that do not itemize deductions at a disadvantage. Taxable income is adjusted gross income minus either the standard deduction or the taxpayer's itemized deduction, whichever is higher.

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