ANALYSIS OF ORIGINAL BILL

Franchise Tax Board

Author:	Haynes	Analyst:	Nicole Kwon	Bill Number:	AB 1262
Related Bills:	See Legislative History	Telephone:	845-7800	Introduced Date:	Feb. 22, 2005
		Attorney:	Patrick Kusiak	Sponsor:	

SUBJECT: Contributions to Nonprofit Educational Assistance Organization Credit

SUMMARY

This bill would create a 75% credit for donations to a nonprofit organization that provides scholarships to elementary and secondary school students.

PURPOSE OF THE BILL

According to the author's office, the purpose of this bill is to expand the educational opportunities of low-income children.

EFFECTIVE/OPERATIVE DATE

This bill is a tax levy and would be effective immediately upon enactment. This credit would apply to taxable years beginning on or after January 1, 2006.

POSITION

Pending.

ANALYSIS

FEDERAL/STATE LAW

Individual taxpayers claim charitable contributions as an itemized deduction. Individual taxpayers are allowed to deduct the greater of the standard deduction or itemized deductions from their adjusted gross income when computing taxable income.

Deductions are allowed for monetary charitable contributions or gifts of property to qualified organizations formed for religious, charitable, educational, scientific, or literary purposes. A charitable contribution is defined as a contribution or gift made exclusively for public purposes. There are limitations on individual charitable contributions. The limitations vary from 20%, 30%, or 50%, depending on the individual's adjusted gross income (AGI) and the amount of contributions made, the types of organizations that receive the donations, and the type of property donated. If an individual's charitable contributions are limited, the excess may be carried over for five years.

Board Position:			Department Director	Date
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Corporate taxpayers are entitled to claim charitable contributions up to 10% of the corporation's taxable income, without regard to the charitable contribution. Any contributions in excess of the 10% limitation may be carried over for five years.

Taxpayers may contribute, with certain limits, up to $2,000 a year to a Coverdell education savings accounts (CESA). A CESA is an individual retirement account (IRA) type of trust account. Earnings of and distributions from a CESA are excluded from taxable income if the funds are used for qualified elementary, secondary, and post-secondary education expenses.

Earnings on contributions to a qualified tuition program (QTP) are excluded from income of the contributor and the student beneficiary if the funds are used for qualified post-secondary education expenses. A deduction for contributions to a QTP is not permitted.

Federal law provides an "above-the-line" deduction of up to $4,000 for educational expenses for the 2005 tax year only. Federal law also provides for the HOPE and Lifetime Learning educational credits. All three items are for post-secondary education expenses. California does not conform to these items.

All of the educational incentives listed above may benefit the taxpayer, taxpayer's spouse, or dependents or benefits an individual explicitly named by the contributor.

THIS BILL

This bill would create a 75% credit for donations to a "qualified educational assistance organization" that provides scholarships to elementary and secondary school students. The credit allowed is limited to a "ceiling" maximum amount of $50,000 per year and any amount of the $50,000 not used may be carried forward to reduce the contributor's tax liability in the succeeding eight taxable years. The minimum "floor" amount that can be contributed and qualify for the credit is $200. The credit appears to be in lieu of a deduction otherwise allowed for 75% of the amount contributed. A deduction for the remaining 25% would appear to still be allowed. The credit is also limited to $20 million in the aggregate for all taxpayers for **all** years. The Franchise Tax Board (FTB) is to prescribe rules and regulations to establish procedures on how the $20 million is to be allocated to the various "qualified educational assistance organizations." The FTB is also to certify to the qualified organizations the total amount of credits available to contributor taxpayers.

The bill provides that "qualified contributions" include cash, stock, bonds, or other marketable securities to a "qualified educational assistance organization." The bill only requires contributions be made to "qualified educational assistance organizations."

A "qualified educational assistance organization" means a nonprofit organization defined in Internal Revenue Code section 501(c)(3), which generally include only those corporations organized and operated exclusively for religious, charitable, educational, scientific, or literary purposes. The qualified educational assistance organization must be certified by the Secretary for Education and allocates at least 90% of the contributions received that qualify for the credit to educational assistance. A qualified educational assistance organization does not include an organization that only awards scholarships to students of only one particular school.

The bill also provides definitions of "income eligible student," "oversight organization," and "qualified student." Various other rules and procedures are provided regarding the administration of the qualified educational assistance organization. Presumably, the definitions, rules, and procedures are to be used by the Secretary for Education.

IMPLEMENTATION CONSIDERATIONS

This bill would require FTB to determine how the $20 million cap is to be allocated among the various qualified organizations and to certify to the qualified organizations the total amount of credits available to contributor taxpayers. To ensure the $20 million credit cap is not exceeded, the $20 million must be allocated before the credit can be claimed on a tax return. Typically, credits involving allocations among taxpayers and areas for which the department does not possess specific expertise, are certified by another agency with the relevant expertise. The certification language would specify the responsibilities of both the certifying agency and the taxpayer. In this case, the certifying agency should be the Department of Education. The bill does state the Secretary for Education is to classify the qualified educational assistance organization but fails to state the purpose for which the classification will be used. If the author intended the Secretary to certify, then it is unclear what the Secretary is to certify. Most of the language in this bill belongs in the Education Code.

TECHNICAL CONSIDERATIONS

The bill defines “qualified contributions” as including cash, stock, bonds, or other marketable securities. It appears the author desires to allow cash or “cash equivalents” to be contributed. “Cash equivalents” are items that can be quickly turned into cash generally on an established market such as the New York Stock Exchange. Many stocks, bonds, or other marketable securities are not cash equivalents and the fair market value of the item is difficult to establish. This is especially true with stock of a closely held corporation where a minority interest of shares are contributed. However, by use of the term “includes,” the description does not exclude donations of other property. In addition, while the term “qualified contributions" is used to describe allocation rules for recipients, the term is not used in describing a contribution for which a credit is allowed under the bill.

LEGISLATIVE HISTORY

SB 1273 (Haynes, 2002) contained similar provisions to this bill. SB 1273 failed passage out of the Senate Revenue and Taxation Committee.

OTHER STATES’ INFORMATION

The states surveyed include *Florida, Illinois, Massachusetts, Michigan, Minnesota,* and *New York.* These states were selected due to their similarities to California's economy, business entity types, and tax laws. *Florida, Illinois, Massachusetts, Michigan,* and *New York* laws do not provide a credit comparable to the credit allowed by this bill.

Minnesota allows a 75% credit for educational expenses, including piano lessons, of the taxpayer’s child. Only taxpayers with total household income below $37,500 qualify for the credit.

FISCAL IMPACT

If the implementation and technical considerations addressed in this analysis are resolved, the department’s costs are expected to be minor.

ECONOMIC IMPACT

Revenue Estimate

Based on discussion below, the revenue loss from this bill is as follows:

Estimated Revenue Impact of AB 1262 Effective Tax Years BOA 1/1/06 Assumed Enactment Date After 6/30/05 (In Millions)		
2005/06	**2006/07**	**2007/08**
n/a	- $13	- $6

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 revenue impact of this bill is dependent upon the dollar value of cash and non-cash charitable contributions made to qualified organizations by taxpayers that currently report itemized deductions in addition to those taxpayers that contribute but currently do not benefit from itemizing. Therefore, the revenue impact is determined by comparing the revenue loss of itemizing charitable contribution deductions (current deductions x marginal average tax rate) versus total redirected contributions for itemized and non-itemized contributions in the form of a credit ((total contributions x 75%) + (total contributions x 25% x 6%)).

According to the University of San Francisco's California nonprofit database, during 2004, approximately $157.3 billion in revenues were generated by nonprofit, public charity entities, and by sub-sector $18.7 billion fell within the education sector. It is assumed that 0.5% of education revenues represent current contributions that would satisfy the standards outlined in this proposal. Therefore, current qualified contributions of $94 million ($18.7 billion x 0.5% = $94 million), clearly exceeds the limit on contributions associated with imposing a $20 million credit threshold ($20 million ÷ 75% = $27 million in contributions). Therefore, this estimate does not consider taxpayers that currently contribute to other sectors that would redirect their funds to education.

To determine the revenue impact, implications of current law qualifying contributions must be determined. Since total contributions are limited to $27 million, it is assumed that all contributions would be reported as an itemized deduction. Applying an average marginal tax rate of 6% results in current law losses of $1.6 million ($27million x 6% = $1.6 million)

Limiting total contributions to $27 million would generate $20 million in credits ($27million x 75% = $20 million). In addition, it is assumed that that the remaining 25% ($27million x 25% = $7million) would be reported as an itemized deduction, as the proposal allows. Applying an average marginal tax rate of 6% to the remaining contributions result in losses of $400,000 ($7 million x 6%). Total losses under this proposal would approximate $20.4 million ($20 million in credits + $400,000 in deductions)

In summary, the net revenue impact would total $18.8 million in losses ($20.4 million - $1.6 million). Assuming that the allocation process is completed by January 1, 2006, of total credits generated, it is estimated that 70% ($18.8 million x 70% = $13 million) will be used during the first year and the remaining 30% ($18.8 million x 30% = $6 million) will be used the following fiscal year. Estimates were rounded to the nearest million dollars.

POLICY CONCERNS

This bill would provide a credit for making donations to nonprofit organizations for scholarships to students equal to 75% of the donation. In combination with the federal deduction and the remaining 25% state deduction for a charitable contribution, some taxpayers could receive a tax benefit for 100% or more of the expense. The department has found that credits in an amount equal to or in excess of the incurred costs have the potential to lead to abuse because the taxpayer is not at risk for the activity that generates the credit.

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