Franchise Tax Board

ANALYSIS OF ORIGINAL BILL

Author:	Baca	Analyst:	Deborah Barrett	Bill Number:	AB 2437
Related Bills:	See Legislative History	Telephone:	845-4301	Introduced Date:	02-23-2006
		Attorney:	Patrick Kusiak	Sponsor:	

SUBJECT: Allow Taxpayers To Designate On PIT Return Amount In Excess Of Tax Liability To Be Deposited Into Qualified Tuition Program Account

SUMMARY

This bill would allow taxpayers to direct any overpayment of tax to a Qualified Tuition Program (QTP) account.

PURPOSE OF THE BILL

According to the author's office, the purpose of this bill would be to encourage taxpayers to save for the future educational expenses for themselves or their dependents.

EFFECTIVE/OPERATIVE DATE

This bill would be effective on January 1, 2007, and operative for designations made on tax returns filed on or after that date.

POSITION

Pending

ANALYSIS

<u>FEDERAL/STATE LAW</u>

Current federal law provides tax-exempt status to "qualified tuition programs" (QTPs). QTPs are programs established and maintained by a state, an agency, or an eligible educational institution to encourage saving for future education expenses of a designated beneficiary. Distributions and earnings from a QTP are not taxable except to the extent the distributions exceed qualified higher education expenses, as defined. Contributions to a QTP are not deductible.

California law conforms to federal law as it relates to tax-exempt QTPs. In addition, state law in the Education Code known as the Golden State Scholarshare Trust Act establishes authority for California's qualified state tuition plan. There is no limitation on who may make a contribution to a Golden State Scholarshare Trust Account or where a designated beneficiary must incur qualified higher education expenses.

Board Position:			Department Director	Date
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Under current state law, the Controller has the discretion to offset any amount due a state agency from a person or entity against any amount owing that person or entity by any state agency. FTB administers the Interagency Intercept program on behalf of the Controller. The Interagency Intercept Program requires, through an annual enrollment process, other state agencies and the IRS to provide FTB with a list of debtors and amounts owed to be offset in the following tax filing season. As returns are filed, and tax refunds issued, any refunds due the taxpayer are offset to satisfy the debts identified by the participating agencies. All participating agencies are charged an administrative fee to cover the cost of the Intercept Program.

THIS BILL

This bill would allow taxpayers to designate on their tax return that an amount be deposited to the credit of the taxpayer's qualified tuition program, as defined. The designation is only allowed in full dollar amounts, with a minimum amount of $250.00. The bill would authorize Franchise Tax Board (FTB) to prescribe the manner and form of the application that would be required to accompany the return to include the amount of the designation and account numbers and named beneficiaries of the QTP.

This bill would further provide that if the overpayments on a tax return are not enough to cover the tax liability and the amount designated for the QTP as shown on the tax return, the tax return will be treated as though the designation had not been made. If a taxpayer designates a deposit to more than one QTP and the overpayment amount available is insufficient to satisfy the total amount designated, the deposits would be allocated among the designated accounts on a prorata basis.

IMPLEMENTATION CONSIDERATIONS

The department has identified the following implementation concerns. Department staff is available to work with the author's office to resolve these and other concerns that may be identified.

- Permitting taxpayers to designate return overpayments to a QTP would replace the priority of the current refund offset program that remits overpayments to other state and local agencies for delinquent debts owed by the taxpayer. If it is the author's intent that QTP contributions have priority over refund offset requests, express language should be added to clarify the author's intent

- This bill would require the department to modify existing tax forms and instruction booklets and make changes to the computer systems, which could be accomplished during normal annual updates but could require additional funding as described below under Fiscal Impact.

- This bill contains two provisions that may ultimately conflict. 1) The minimum amount of designation is $250, and if the payments and the designation reported on the return do not exceed the tax liability, FTB is to treat the return as if no designation has been made. 2) In instances where a taxpayer has multiple QTPs designated and there are insufficient funds for all designations, a prorata distribution is to be applied. The conflict would occur under the following scenario: Two QTPs are designated, but only $400 is available. If the amount is prorated, both QTPs would receive $200. Since this amount is below the minimum, it is not clear whether FTB should send one account the full amount of $400, send one account $250 and refund the remaining $150, or disregard the designation for both and refund the full amount to the taxpayer. Additional clarification is needed to ensure FTB takes the action the author intended.

OTHER STATES' INFORMATION

The states reviewed include *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. These states have no laws similar to the provisions of this bill.

FISCAL IMPACT

Implementation of this bill could require changes to existing tax forms and electronic applications resulting in the current tax return expanding to three pages. If the forms did increase to three pages, the department would incur costs of over $2 million for revising the forms and instructions, printing, systems changes, processing, and storage.

This bill would require the development of an additional form that would also impact departmental printing, processing, and storage costs. This bill would also require additional administrative and system programming costs to manage the transfer of funds to entities designated by the taxpayer. The additional costs will be identified and, if needed, an appropriation requested as the bill moves through the legislative process.

ECONOMIC IMPACT

Estimated Revenue Impact of AB 2437 As Introduced 2/23/06 ($ In Millions]		
2006-07	2007-08	2008-09
a/	a/	a/
a/ Negligible gains or losses of less than $250,000.		

This bill would result in negligible gains or losses of less than $250,000 in any given year. Providing an additional mechanism to induce deposits would not necessarily increase total deposits to QTP accounts. Individuals who are going to contribute to an account are likely to contribute without a tax refund mechanism.

Contributions to QTP accounts do not directly cause a revenue effect; it is the eventual tax-free distribution of deferred investment returns for qualified education expenses that impact revenue. Since it is unlikely a distribution from a QTP would occur in the same year a contribution occurred, any incremental revenue effects of tax-free distributions would be in future years.

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