

ANALYSIS OF AMENDED BILL

Author: Niello Analyst: Angela Raygoza Bill Number: AB 2561
 Related Bills: See Legislative History Telephone: 845-7814 Amended Date: April 3, 2008
 Attorney: Patrick Kusiak Sponsor: _____

SUBJECT: Private School Tuition Credit

SUMMARY

This bill would provide an income tax credit for the costs paid or incurred for tuition at private school.

SUMMARY OF AMENDMENTS

The April 3, 2008, amendments would do the following:

- Provide an income tax credit in an amount equal to the amount of tuition paid to a private school or \$5,000, whichever is less,
- Define the term "tuition," and
- Allow the credit to be carried over in future years until exhausted.

This is the department's first analysis of this bill.

PURPOSE OF THE BILL

According to the author's office, the purpose of this bill is to provide school options to parents or guardians with students in low-performing schools for a better education.

EFFECTIVE/OPERATIVE DATE

As a tax levy, this bill would be effective immediately upon enactment and specifically operative for taxable years beginning on or after January 1, 2010.

POSITION

Pending.

| | | |
|--|---------------------|---------|
| Board Position: | Department Director | Date |
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ANALYSIS

FEDERAL/STATE LAW

Existing state and federal laws provide various tax credits designed to provide tax relief for taxpayers who incur certain expenses (e.g., child adoption) or to influence behavior, including business practices and decisions (e.g., research credits or economic development area hiring credits). These credits generally are designed to provide incentives for taxpayers to perform various actions or activities that they may not otherwise undertake.

In addition, current federal and state laws allow a tax deduction for limited types of personal expenses. Some personal expenses, including certain taxes and home mortgage interest, generally are fully deductible. Deductible personal medical and dental expenses must exceed 7.5% of the taxpayer's adjusted gross income¹ (AGI), while other miscellaneous itemized deductions, including unreimbursed employee expenses, job education, and tax preparation fees, must exceed 2% of AGI. Generally, expenses paid or incurred for the education of a child are considered personal expenses, which are not deductible.

THIS BILL

Beginning on or after January 1, 2010, this bill would allow a personal income tax credit for an amount equal to the tuition paid to a participating private school as described in the Education Code² or \$5,000, whichever is less. This credit applies to pupils in kindergarten through eighth grade. The Education Code provides that eligibility for the tax credit with respect to tuition requires the private school do all of the following:

- Demonstrate fiscal soundness by being in operation for one school year or by providing the State Department of Education with a financial statement by a certified public accountant.
- Accept pupils on an entirely random basis without regard to the pupil's past academic history.
- Be subject to the instruction, curriculum, and attendance criteria adopted by an appropriate nonpublic school accrediting body, and be academically accountable to the parent or guardian for meeting the educational needs of the pupil.
- Comply with the requirements of all applicable state statutes and regulations relating to private elementary or secondary schools, the requirements of applicable state and local health and safety laws and codes, and with the requirements of Education Code section 220, which prohibits discrimination.

This bill would define "tuition" as enrollment fees, textbook fees, laboratory fees, and other fees related to instruction, including the cost of transportation of the pupil between his or her home and the school.

This bill would allow excess credits to be carried to future years until exhausted.

¹ Adjusted Gross Income as defined by IRC 62 means gross income minus deductions.

² Education Code section 49045.7

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.

- This bill would allow a tax credit for the costs paid or incurred for private school tuition. The bill fails to specify who would be eligible to receive the credit. Without clarification, it could be interpreted that anyone can take a credit for tuition paid to a private school. The author may wish to amend the bill to specify criteria under which a taxpayer or "qualifying pupil" would qualify for the credit. For instance, the author may require that in order to receive the credit the taxpayer must be able to claim the private school attendee as a dependent on the tax return.
- This bill uses terms that are undefined, "private school," "other fees," "pupil," and "school." The absence of definitions to clarify these terms could lead to disputes with taxpayers and would complicate the administration of this credit.
- It is unclear what expenses qualify as "costs for transporting the pupil." Without clarification, it could be interpreted that the services of a chauffeur, the purchase of skates or scooters, standard rate per mile, and/ or the costs to maintain and insure the family vehicle could qualify a taxpayer for this credit.
- This bill would allow a credit for the tuition paid, but fails to specify how long the "pupil" must attend the private school to qualify for this credit. As a result, it appears that both part-time and part-year attendance would qualify. The author may wish to amend the bill to specify the length of attendance that would be required to receive the credit and include recapture language in the event the "pupil" fails to complete the required attendance.
- FTB would have difficulty determining the eligibility of a private school. Typically, credits involving areas for which the department lacks expertise are certified by another agency or agencies that possess the relevant expertise. The author may also wish to amend the bill to include language that would require certification that a "pupil" is attending a private school. The certification language would specify the responsibilities of both the certifying agency and the taxpayer. The language should also require that the certification be provided to the department upon request.
- The bill would add provisions to the Education Code that would appear to specify qualifications for the tax credit, but those qualifications are not included in the Revenue and Taxation Code (R&TC). Because the tax credit would be administered through the R&TC and as a matter of code maintenance, it is recommended that the bill be amended to provide the specific criteria for the tax credit in the R&TC.
- This bill references an operative date of July 1, 2010, throughout the Education Code but provides for an operative date of January 1, 2010, in the R&TC. To clarify when this bill would be operative, the bill should be amended to include consistent operative dates.

TECHNICAL CONSIDERATIONS

Amendment 1 has been provided to correct a technical error.

LEGISLATIVE HISTORY

AB 2605 (Nakanishi, 2007/2008) would allow a \$500 tax credit to qualified taxpayers for each dependent attending a qualified nonpublic school. This bill is currently in the Assembly Revenue and Taxation Committee.

AB 33 (Jefferies, 2007/2008) would have allowed a tax credit in the amount of 20% for costs paid or incurred by a taxpayer for school transportation costs. AB 33 failed to pass out of the first house by January 31, 2008, the second year of the session.

AB 2077 (Strickland, 2005/2006) is similar to AB 2561 as it would have allowed a \$5,000 tax credit to a taxpayer for the costs paid or incurred for tuition at any private Kindergarten to 12th grade school located in California. AB 2077 failed to pass in the Assembly Revenue and Taxation Committee.

AB 49 (House, 1999/2000) would have allowed a taxpayer to claim a \$500 credit for each child of a taxpayer that attended a private school in this state. AB 49 failed passage out of the first house, by January 31, 2000, the second year of the session.

OTHER STATES' INFORMATION

Review of *Florida, Illinois, Massachusetts, Michigan, Minnesota, and New York* laws found that *Minnesota* and *Illinois* are the only states that have a credit similar to the credit in this bill. These states were reviewed because of the similarities to California's income tax laws.

Minnesota allows taxpayers in an amount equal to 75% of the amount paid for education-related expenses for a qualifying child in kindergarten through grade 12. Education-related expenses include transportation costs; however, there is an adjusted gross income (AGI) limitation for qualifying taxpayers.

Illinois allows a parent or legal guardian of one or more qualifying pupils to an income tax credit for expenses incurred on behalf of the qualifying pupils equal to 25% of qualified education expenses. Qualifying pupil means full-time student enrolled in private or public elementary or secondary schools from kindergarten through 12th grade. The maximum amount of the credit is \$500. Qualifying expenses include tuition, book fees, and lab fees over \$250 incurred on behalf of a qualifying pupil.

FISCAL IMPACT

The department's costs to administer this bill cannot be determined until the implementation considerations discussed above have been resolved, but they are anticipated to be minor.

ECONOMIC IMPACT

Revenue Estimate

Based on data and assumptions discussed below, this bill would result in the following annual revenue losses beginning in tax year 2010:

| Estimated Revenue Impact of AB 2561 | | |
|---|-----------|---------|
| Effective for Tax Years Beginning On Or After January 1, 2010 | | |
| (\$ in Millions) | | |
| 2008-09 | 2009-10 | 2010-11 |
| No impact | No impact | -\$3 |

This analysis does not account for changes in employment, personal income, or gross state product that could result from this bill.

Revenue Discussion

The revenue impact of the bill would depend on the number of students who qualify a parent or guardian for the tax credit and the amount of tax credits that can be applied to reduce tax liabilities.

According to the California Department of Education, there are 4.2 million pupils in the public school system in kindergarten through 8th grade. For purposes of this estimate, it is assumed that 5%, or 210,000 of these pupils are in qualified low performing schools ($4.2 \text{ million} \times 5\% = 210,000$). Under this bill, these 210,000 pupils would be eligible for transfers to higher performing schools or qualify their parent or guardian for the proposed tax credit equal to the amount paid for tuition, books, fees, and transportation up to \$5,000, whichever is less.

Based on research, this estimate assumes that 10% or 21,000 pupils ($210,000 \times 10\%$) would choose a nonpublic school. Using an average of \$3,000 for qualified tuition, fees, and transportation, \$63 million in credits would be generated ($21,000 \times \$3,000$). Of the 21,000 pupils, it is assumed that 50% of the pupils or 10,500 ($21,000 \times 50\%$), have a parent or guardian with a tax liability. It is assumed that the average tax liability for this group would be \$500. Therefore, 10,500 parents or guardians would apply tax credits of approximately \$5.2 million for the first school year ($10,500 \times \$500$). Although the proposed tax credit would apply to taxable years beginning on or after January 1, 2010, it would be limited to school years beginning on or after July 1, 2010. As a result, the revenue impact of this bill would not occur until fiscal year 2010-2011. The above chart reflects fiscal year estimates.

POLICY CONCERN

This bill lacks a sunset date. Sunset dates generally are provided to allow periodic review of the effectiveness of the credit by the Legislature.

This bill would allow for an unlimited carryover period. Consequently, the department would be required to retain the carryover on the tax forms indefinitely. Recent credits have been enacted with a carryover period limitation because experience shows credits typically are exhausted within eight years of being earned.

LEGISLATIVE STAFF CONTACT

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FRANCHISE TAX BOARD'S
PROPOSED AMENDMENTS TO AB 2561
As Amended April 3, 2008

AMENDMENT 1

On page 3, line 18 ~~strikeout~~ "legislation" and insert:

section