Franchise Tax Board

ANALYSIS OF AMENDED BILL

Author:	Nakanishi, et al.	Analyst:	William Koch	Bill Number:	AB 2605
Related Bills:	See Legislative History	Telephone:	845-4372	Amended Date: Introduced Date:	April 7, 2008 & February 22, 2008
		Attorney:	Patrick Kusiak	Sponsor:	

SUBJECT: Nonpublic School Tax Credit

SUMMARY

This bill would allow a tax credit to qualified taxpayers for each dependent attending a qualified nonpublic school.

This analysis addresses only provisions of the bill that would impact the Franchise Tax Board (FTB). This is the department's first analysis of this bill.

SUMMARY OF AMENDMENTS

The April 7, 2008, amendments revised the criteria for taxpayers to be eligible for the nonpublic school attendance tax credit proposed by this bill.

PURPOSE OF THE BILL

According to the author's office, the purpose of this bill is to relieve a portion of the financial burden for parents whose children attend a nonpublic school.

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, 2009, and before January 1, 2014.

POSITION

Pending.

Board Position:			Department Director	Date
_______ S	_______ NA	_______ NP		
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_______ N	_______ OUA	___X___ PENDING		

ANALYSIS

FEDERAL/STATE LAW

Existing federal and state 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 income (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.

Federal law currently allows a Hope Scholarship Credit and Lifetime Learning Credit for certain tuition expenses, as well as a deduction for interest due and paid on a qualified higher education loan. California law conforms to federal law as it relates to tax-exempt Qualified Tuition Programs. 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.

California law does not allow an above-the-line[1] deduction for qualified higher-education expenses.

THIS BILL

For taxable years beginning on or after January 1, 2009, and before January 1, 2014, this bill would provide qualified taxpayers a personal income tax credit in the amount of $500 for each dependent that is exempt from attending a public school, as specified in California Education Code sections 48222, 48223 and 48224. In general, these sections exempt students from attending a public school if they attend a private school or if they are instructed by a credentialed, private tutor.

A qualified taxpayer is defined as a person whose income is less than 400% of the poverty guidelines issued in the Federal Register by the United States Department of Health and Human Services.

This bill would specify that a taxpayer may only be eligible for the credit if the child exempt from attending a public school can be claimed as a dependent on the taxpayer's tax return.

[1] "Above-the-line" deductions are amounts that may be deducted in computing adjusted gross income, and such deductions may be taken without regard to whether a taxpayer itemizes deductions.

This bill would allow any unused portion of the credit to be carried over until exhausted.

This credit would be repealed as of December 1, 2014.

This bill would require the Legislative Analyst's Office to prepare a study on the effectiveness of this tax credit and to report the results of the study to the Legislature by January 1, 2013.

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.

1. This bill fails to specify how long a dependent must attend a nonpublic school to qualify a taxpayer for this credit. As written, it would appear that a dependent could attend a private school for less than the entire school year and qualify for the credit. To alleviate disputes between taxpayers and the department, the author may wish to amend the bill to specify a minimum length of time that a dependent must attend in order to qualify for the credit. The author may also consider adding recapture language in the event that the dependent fails to attend for the specified length of time.

2. This bill defines a qualified taxpayer as a person whose income is less than 400% of the poverty guidelines as issued in the Federal Register. The poverty guidelines issued in the Federal Register are based on family size. FTB lacks the ability to verify household or family income. Other tax benefits, such as the renter's credit, generally are tied to the California adjusted gross income[2] (AGI) amount. To ease the administration of this credit, the author may wish to amend the bill to base the eligibility of a taxpayer on criteria the department is able to determine, such as AGI.

3. FTB would have difficulty verifying if a taxpayer's dependent is exempt from attending a nonpublic 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 wish to amend the bill to include language that would require certification that a child is exempt from attending a public school, and that the conditions set forth in section 48222, 48223, and/or 48224 of the Education Code were satisfied. 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.

[2] California adjusted gross income is federal adjusted gross income from all sources reduced or increased by all California income adjustments. Federal adjusted gross income is defined by Internal Revenue Code section 62 and means gross income minus deductions.

LEGISLATIVE HISTORY

AB 2561 (Niello, 2007/2008) would allow a private school tuition credit of up to $5,000. This bill is currently in the Assembly Revenue and Taxation Committee.

AB 2077 (Strickland, 2006/2007) contained similar provisions to this bill. AB 2077 failed to pass out of the Assembly Committee on Revenue and Taxation by the constitutional deadline.

AB 49 (House, 1999/2000) contained similar provisions to this bill. AB 49 failed passage out of the Assembly Committee on Revenue and Taxation.

OTHER STATES' INFORMATION

The states surveyed include *Florida*, *Illinois, Massachusetts, Michigan* and *New York.* These states were selected due to their similarities to California's diverse population, economy, and tax laws. Except for *Illinois*, none of these states have a credit similar to the credit proposed by this bill.

Illinois allows a credit for expenses incurred on behalf of qualifying pupils equal to 25% of qualified education expenses for the parents or legal guardians of one or more qualifying pupils. 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 concerns have been resolved, but are anticipated to be minor.

ECONOMIC IMPACT

<u>Revenue Estimate</u>

This bill would result in the following revenue losses:

Estimated Revenue Impact of AB 2605 Effective for Tax Years Beginning On or After January 1, 2009 ($ in Millions)		
2008-09	2009-10	2010-11
-$5	-$13	-$15

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 this bill would depend on the number of students in nonpublic education for one or more days beginning in taxable year 2009, the number of taxpayers in income groups eligible for the tax credit, and the amount of credits that can be applied to reduce tax liabilities.

Based on information from the California and the U. S. Departments of Education, there are expected to be 723,324 students in nonpublic education in California in the 2007-08 school year. This population was adjusted for fiscal year 2008-09 and future years based on enrollment trends. Utilizing United States census data, based on the definition of a qualified taxpayer, as well as the requirement that private tutors have a valid teachers credential, it is assumed that of the 723,324 students, 43,083 students would qualify for the credit. When the qualified population is multiplied by the $500 credit, the potential credit per school year is approximately $21 million (43,083 x $500) for fiscal years 2008/09, 2009/10, and 2010/11.

This analysis assumes that 90% of the enrolled students have their tuition paid by a taxpayer who also claims them as a dependent, thereby, reducing potential credits to approximately $19 million for tax years 2009, 2010, and 2011 (21 million x 90%). It is estimated that 67% of the credits are applied to reduce liabilities in the tax year generated. Remaining credits are carried over and applied in the subsequent three years, resulting in approximately $13 million in credits being claimed for tax year 2009, $14 million in 2010, and $15 million in 2011.

For fiscal year 2008-09, the revenue impact of $5 million reflects reduced estimated payments. In each successive fiscal year, applied credits increase due to the use of credits carried over from prior years.

POLICY CONCERNS

Credits generally are designed to encourage a desired behavior. This bill would allow a credit for behavior in which taxpayers may be currently engaged. For example, a taxpayer currently enrolling his or her child in a private school would receive this credit.

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.

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