Franchise Tax Board

ANALYSIS OF ORIGINAL BILL

Author:	Runner	Analyst:	Nicole Kwon	Bill Number:	AB 819
Related Bills:	See Legislative History	Telephone:	845-7800	Introduced Date:	February 22, 2007
		Attorney:	Patrick Kusiak	Sponsor:	

SUBJECT: Qualified Tuition Program Deduction

SUMMARY

This bill would allow a deduction for contributions made by a qualified taxpayer to certain qualified tuition programs.

PURPOSE OF THE BILL

According to the author's office, the purpose of this bill is to allow an additional tax benefit for taxpayers that make contributions to a qualified tuition program, thus providing tax relief to those taxpayers.

EFFECTIVE/OPERATIVE DATE

As a tax levy, this bill would be effective immediately upon enactment and operative for taxable years beginning on or after January 1, 2007.

POSITION

Pending.

ANALYSIS

FEDERAL/STATE LAW

Under federal law, Internal Revenue Code (IRC) Section 529 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 purchase tuition credits or make cash contributions on behalf of designated beneficiaries. Only states may establish cash benefit QTPs. No amount is included in the gross income of a contributor to, or a beneficiary of, a QTP with respect to any distribution from, or earnings under, such program, except to the extent such distributions exceed qualified higher education expenses.

Board Position:			Department Director	Date
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Any person may make contributions to a Section 529 plan. Under federal law, contributions made to a Section 529 plan are not deductible. Under the Internal Revenue Service-established "safe harbor," contributions in excess of those necessary to provide qualified higher education expenses of the beneficiary are prohibited.

Federal law allows eligible individuals an above-the-line deduction for qualified higher-education expenses paid during the taxable year. For 2003, the maximum deduction was $3,000 for taxpayers with modified Adjusted Gross Income (AGI) not in excess of $65,000 ($130,000 for a joint return). For taxable years after 2003, the maximum deduction for these taxpayers is $4,000 for taxpayers with modified AGI in excess of $65,000 ($130,000 joint) and $2,000) for married filing a separate return with AGI in excess of $80,000 ($160,000 joint).

Under current state law, the Family Code permits the establishment of domestic partnerships. Registered domestic partners (RDPs) have the same rights, such as community property rights, and obligations that are granted to and imposed upon spouses in a civil marriage, with some exceptions.

Effective for taxable years beginning in 2007, RDPs are required to file a personal income tax return jointly or separately by applying the standards applicable to married couples under federal income tax law. (SB 1827, Migden, Stats. 2006, Ch. 802.)

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.

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

THIS BILL

This bill would allow qualified taxpayers a deduction for contributions made to all QTPs under IRC Section 529. This bill specifically sets a limit on the amount of contributions eligible for the deduction at $3,000/$6,000 (single/married filing jointly or head of household) per taxable year.

This bill would define a "qualified taxpayer" to mean an individual who, on behalf of a beneficiary, contributes money to a qualified trust and meets all of the other requirements of Section 529 of the IRC.

IMPLEMENTATION CONSIDERATIONS

The department has identified the following implementation concern.

RDPs are required to file California income tax returns using the rules applicable to married individuals. If the author's intention is to allow the same deduction provided in this bill for RDPs as married individuals, a rule should be included to address the difference between federal and state law. Department staff is available to work with the author's office to resolve the implementation concerns.

LEGISLATIVE HISTORY

SB 643 (Florez, 2007/2008) would allow a deduction for contributions made by a qualified taxpayer to a QTP and require the Scholarshare Investment Board to make a one-time contribution to certain qualified tuition programs. SB 643 is currently at Senate Revenue & Taxation Committee, set for hearing.

SB 30 (Speier, 2005/2006) and AB 3 (Blakeslee, 2005/2006) were similar to this bill in regards to allowing qualified taxpayers a deduction for contributions made to a QTP. SB 30 did not pass out of the Senate Revenue & Taxation Committee; AB 3 did not pass out of the Assembly Revenue & Taxation Committee.

SB 1262 (Stats. 1999, Ch. 664) made a number of technical changes to the California Golden State Scholarshare program under the Education Code, including making the Scholarshare Investment Board, which is chaired by the state Treasurer, responsible for administering the program instead of the Student Aid Commission.

AB 2797 (Stats. 1998, Ch. 322) allows, by direct conformity to the federal provisions, an exemption from state taxation and tax deferred treatment for contributions to and earnings from any state's qualified state tuition program.

AB 530 (Stats. 1997, Ch. 851) established the California Golden State Scholarshare program in conformity with the federal qualified state tuition criteria. It provides an exemption from state taxation and tax deferred treatment for earnings from the Scholarshare program.

Federal P.L. 104-188 (1996), amended by P.L. 105-34 (1997), established an exemption from federal taxation and tax-deferred treatment for contributions to and earnings from qualified state tuition programs.

OTHER STATES' INFORMATION

The states surveyed include *Illinois, Massachusetts,* and *New York.* These states were selected due to their similarities to California's economy, business entity types, and tax laws.

Illinois has the College Savings Pool program named "Bright Start." A deduction is allowed from an individual's AGI for contributions made to the College Savings Pool.

Massachusetts is aligned with federal treatment of QTPs under IRC Section 529, excluding distributions from the beneficiary's federal gross income to the extent the distribution is used to pay for qualified higher education expenses.

New York has the New York State College Savings Program in which an account owner may deduct contributions made to one or more family tuition plans from federal AGI in computing New York AGI.

FISCAL IMPACT

This bill would not significantly impact the department's costs.

ECONOMIC IMPACT

Revenue Estimate

Based on data and assumptions discussed below, this bill would result in the following revenue losses annually beginning in 2007-08.

Estimated Revenue Impact of AB 819 As Introduced February 22, 2007 ($ in Millions)		
2007-08	2008-09	2009-10
-$85	-$100	-$125

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

Revenue Discussion

The revenue impact of the bill would be determined by the amount of contributions to QTPs deducted on tax returns each year and the marginal tax rate of taxpayers reporting such adjustments to income.

Based on data from the Investment Company Institute, total contributions by California taxpayers to QTPs are projected at approximately $1.9 billion in 2007. As this bill is a state-only adjustment to income, it is anticipated that contributions deducted on tax returns for the 2007 taxable year would be approximately 60% of the $1.9 billion, or approximately $1.1 billion ($1.9 billion x 60%). This means that many taxpayers entitled to the adjustment simply neglect to report it for various reasons in the initial tax year of the deduction. Contributions deducted on tax returns are projected to increase each subsequent year due to growth in the number of QTP accounts and increased knowledge of the deduction available.

Applying an average marginal tax rate of 6.5% to the amount of deductible contributions derives a revenue loss of $74 million for the 2007 taxable year ($1.1 billion x 6.5% = $74 million). Taxable year estimates are converted to cash-flow revenue estimates above. For example, the 2007-08 cash flow estimate of $85 million consists of $74 million for the 2007 taxable year and $10 million for the 2008 taxable year. Estimates are rounded to the nearest $5 million, thus the $85 million estimate for 2007-08.

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