Franchise Tax Board

SUMMARY ANALYSIS OF AMENDED BILL

Author: Steinberg Analyst: Deborah Barrett Bill Number: SB 752

Related Bills: See Prior Analysis Telephone: 845-4301 Amended Date: April 18, 2007

Attorney: Patrick Kusiak Sponsor: ____

SUBJECT: Exclusion/California Kids Investment & Development Savings (KIDS) Account Earnings, Contributions, or Qualified Distributions

__X__ DEPARTMENT AMENDMENTS ACCEPTED. Amendments reflect suggestions of previous analysis of bill as introduced February 23, 2007.

____ AMENDMENTS IMPACT REVENUE. A new revenue estimate is provided.

__X__ AMENDMENTS DID NOT RESOLVE THE DEPARTMENT'S CONCERNS stated in the previous analysis of bill as introduced February 23, 2007.

____ FURTHER AMENDMENTS NECESSARY.

____ DEPARTMENT POSITION CHANGED TO ____________.

__X__ REMAINDER OF PREVIOUS ANALYSIS OF BILL AS INTRODUCED February 23, 2007, STILL APPLIES.

____ OTHER – See comments below.

SUMMARY

This bill would establish the California Kids Investment and Development Savings (KIDS) Account Act that would provide a $500 savings account for every child born in California after a specified date.

SUMMARY OF AMENDMENTS

The April 17, 2007, amendments would do the following:

- Require the State Treasurer to withhold from distribution KIDS funds an amount equal to the initial deposit if non-qualified distributions are made, instead of having the taxpayer pay that amount to the Franchise Tax Board,
- Remove references to Internal Revenue Code section 72 that pertains to IRA accounts, and
- Remove a provision that the amounts in the account could not be considered when determining eligibility for federal low-income assistance.

The amendments did not address all of the Implementation and Policy Concerns identified in the department's analysis of the bill as introduced February 23, 2007. The unresolved concerns are restated here for convenience and a new Implementation Concern has been identified. The "This Bill" and "Fiscal Impact" discussions have been revised. The remainder of the department's analysis of the bill as introduced February 23, 2007, still applies.

Board Position:			Legislative Director	Date
____ S	____ NA	____ NP		
____ SA	____ O	____ NAR	Brian Putler	5/30/07
____ N	____ OUA	__X__ PENDING		

THIS BILL

This bill would establish the California KIDS Account Act. Under this act, every child born in California on or after January 1, 2008, would have $500 deposited into an account in the State Treasury by the State. Parents, legal guardians, grandparents, local organizations, corporations, or others would be able to make a voluntary contribution to the child's account. Any individual who is 18 years or older may withdraw funds from the account without incurring a tax liability for the following purposes:

- Pay for his or her postsecondary education, career technical education, or training;
- Buy his or her first home; or
- Fund his or her retirement account.

The KIDS account is exempt from state income taxation. If the assets of such account are distributed for reasons other than the qualified purpose, then the earnings in the KIDS account are required to be included in the gross income of the accountholder in accordance with federal rules for annuities, as modified. The funds held in a KIDS account may not be taken into account for purposes of determining the eligibility of an individual for a state program intended to provide assistance to low income people.

For each taxable year, beginning on or after January 1, 2008, the following would be excluded from the California gross income of an accountholder of a California KIDS account:

- Any earnings in the KIDS account,
- Any contribution to the KIDS account, or
- Any qualified special purpose distribution amount.

If any distribution from a KIDS account is not a qualified special purpose distribution as defined, any earnings in that account are includable in the California gross income of the accountholder for the taxable year in which the distribution is made and is subject to a 10% penalty. An amount equal to the amount of the initial deposit made by the state to the account ($500) would be withheld from a non-qualified distribution of the account by the State Treasurer.

The value of the account, any earnings in the account, and investment in the account would be computed as of the close of the calendar year in which the taxable year begins. No deduction is allowed for contributions to a KIDS account.

This bill would define the terms accountholder, KIDS account, and qualified special purpose distribution for purposes of this section.

IMPLEMENTATION CONSIDERATIONS

Implementation Concerns identified from Department's analysis of the bill as introduced February 23, 2007.

1. Although the bill would allow individuals other than the account holder to contribute to the account, it is not clear whether the child's parents or guardians that normally have control over the affairs of a minor child would have any control over the funds in the account or could make decisions on behalf of the child relating to the account. To prevent any misunderstanding, it is recommended that the author clarify whether any individual other than the account holder has authority over the funds in the account.

2. It is not clear what would happen to the funds in the account in the event the child becomes deceased before the funds are distributed. To avoid any disputes with surviving family members, the author may wish to specify whether the funds belonging to the child become a part of their estate or not.

3. Generally state tax provisions are contained solely within the Revenue and Taxation Code (RTC), rather than in another code as this bill would provide. It is recommended that the tax provisions be moved to the RTC with appropriate cross-references. In addition, the provision in Section 99102 of the Government Code that would authorize the State Treasurer to promulgate rules and regulations to implement the act, may create uncertainty over which state agency is charged with implementing the tax provisions affecting KIDS accounts.

4. Generally, the amount included in California taxable income would be limited to the amount distributed within a given year. The bill appears to require that the entire amount of the investment earnings be included in gross income if there is a nonqualified distribution in any year, without explicitly ending the qualification of the account as a nontaxable account for future years. To remain consistent with general tax law, the author may want to amend the language to specify that the amount of the nonqualified distribution would be the amount subject to tax in a given year, and a nonqualified distribution would convert any funds remaining in the account from a nontaxable account to a taxable account.

5. The bill would provide that the Treasurer establish an account for this program but is silent about who would be responsible for investing the funds in the account or who would provide the administrative support for these accounts, such as earning statements or 1099 reports required by state and federal statutes. The author may want to amend the language to clarify what functions the Treasurer or other entity would be required to perform in relation to these accounts.

6. The bill would establish an account at the Treasurer's office that could have no additional deposits or activity other than the initial deposit. It is not clear whether the inactive accounts would be subject to the Unclaimed Property laws administered by the State Controller. The author may wish to amend the language to prevent the account from being escheated to the state for lack of activity.

Implementation Concern identified from bill as amended April 18, 2007.

The bill provides that the funding for this act would be upon appropriation by the Legislature in its Budget Act of 2007. It is not clear whether the author intends a one-time appropriation for births in the 2008 calendar year or would the program be ongoing in future years and require an appropriation for each year thereafter. The author may want to clarify whether the provisions of this act are for a one-time or ongoing program.

FISCAL IMPACT

This bill would not impact department costs.

ARGUMENTS/POLICY CONCERNS

This bill would create differences between federal and California tax law, thereby increasing the complexity of California tax return preparation.

This bill contains provisions that would target certain incentives to residents of California while denying the same incentive to nonresidents. The U.S. Supreme Court in *Lunding Et Ux. v. New York Appeals Tribunal et al.* (1998) 118 S. Ct. 766, found that New York's denial of an alimony deduction to nonresident taxpayers, while allowing such a deduction to resident taxpayers, was discriminatory and thus unconstitutional. Thus, targeted tax incentives that are conditioned on residency in California may be subject to constitutional challenge.

LEGISLATIVE STAFF CONTACT

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