Franchise Tax Board

ANALYSIS OF AMENDED BILL

Author:	Duvall	Analyst:	Angela Raygoza	Bill Number:	AB 279
Related Bills:	See Legislative History	Telephone:	845-7814	Introduced Date: Amended Date:	February 12, 2009 March 18. 2009
		Attorney:	Patrick Kusiak	Sponsor:	

SUBJECT: Great Schools Tax Credit/Contributions To Scholarship Granting Organization Credit

SUMMARY

This bill would provide a tax credit for contributions made to a scholarship granting organization, as specified.

SUMMARY OF AMENDMENTS

The March 18, 2009, amendments would make technical non-substantive changes and remove a compliance requirement for scholarship granting organizations.

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 encourage taxpayer's to contribute to scholarship programs to provide education options for underprivileged students.

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.

Summary of Suggested Amendments

Amendments have been provided to address technical errors within the bill language.

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.

The Richard B. Russell National School Lunch Act (1946) provides low cost or free school lunch meals to qualified students through subsidies to schools. The program was established as a way to increase food prices by absorbing farm surpluses, while at the same time providing food to school age children, ages 4-18.

Existing federal and state laws allow individuals to deduct certain expenses, such as medical expenses, charitable contributions, interest, and taxes, as itemized deductions. Also, itemized deductions may be further limited for high-income taxpayers.

Current federal and state law allows a corporation and S-corporation to deduct charitable contributions limited to 10 percent of the taxpayer's net income. Contributions in excess of 10 percent may be carried over to the following five succeeding taxable years.

THIS BILL

Beginning on or after January 1, 2010, this bill would provide a tax credit to a qualified taxpayer for the total contribution made to a scholarship granting organization in an amount not to exceed 50 percent of the qualified taxpayer's tax liability.

This bill would define the following terms:

- "Educational scholarship" means a grant made to an eligible student to cover all or part of the tuition and fees, including transportation to a qualified school outside of the eligible student's resident school district, at either a public or nonpublic qualified school.
- "Eligible student" means either of the following:
    - A student who is a member of a household whose total amount of income during the calendar year before he or she receives an educational scholarship from a scholarship granting organization does not exceed an amount equal to approximately $68,000 to qualify for a free lunch or approximately $98,000 for a reduced lunch price[1], who was eligible to attend a public school in the semester preceding receipt of the educational scholarship or is attending school in California for the first time, and who resides in California while receiving the educational scholarship; or

[1] Richard B. Russell National Lunch Act-42 U.S.C. Sec. 1751, et seq.- Children from families with incomes at or below 130 percent of the poverty level are eligible for free meals. Those with incomes between 130 percent and 185 percent of the poverty level are eligible for reduced-price meals, for which students can be charged no more than 40 cents. (For the period July 1, 2008, through June 30, 2009, 130 percent of the poverty level is $27,560 for a family of four; 185 percent is $39,220.

- A student who qualifies for free or reduced price lunch[2].

- A student remains an "eligible student" under this section until he or she graduates high school or reaches 21 years of age, regardless of household income.
- "Parent" means a parent, a legal guardian, a conservator, a person acting as a parent of a child, or any other person with legal authority to act on behalf of the child.
- "Qualified school" means a public elementary or secondary school located in California that is outside of the eligible student's resident school district or a nonpublic elementary or secondary school in California that complies with the requirements of this section. A qualified school shall comply with all state laws that apply to nonpublic schools regarding criminal background checks for employees and exclude from employment any person not permitted by state law to work in a nonpublic school.
- "Qualified taxpayer" means a taxpayer who files an income tax return in this state and is not claimed as a dependent for income tax purposes by any other taxpayer.
- "Scholarship granting organization" means an organization that complies with the requirements of this section and provides educational scholarships to eligible students attending qualified schools of their parent's choice.

This bill would disallow the credit unless the "scholarship granting organization" complies with specific conditions. The conditions discussed below would affect the department and are as follows:

- Notify the Franchise Tax Board (FTB) of its intent to provide "educational scholarships" to "eligible students" attending "qualified schools."
- Provide the FTB with the Internal Revenue Service's Letter of Determination of tax-exempt status as an organization described in Section 501(c) (3) of the Internal Revenue Code (IRC).
- Cooperate with the FTB, or its designee, in conducting criminal background checks of all of its employees and board members and excludes from employment or governance any individual who might reasonably pose a risk to the appropriate use of contributed funds.
- Demonstrate its financial accountability to the FTB by submitting a financial information report, conducted by a certified public accountant (CPA), that complies with uniform financial accounting standards and is certified by an auditor as free of material misstatements.
- If the scholarship granting organization receives donations of $50,000 or more during the school year, the scholarship granting organization would be required to demonstrate its financial accountability by either of the following:

  - Filing a surety bond with FTB, payable to the State of California, in an amount equal to the aggregate amount of contributions expected to be received during the school year; or

[2] Ibid

- o Filing financial information prior to the school year with FTB that demonstrates the financial viability of the "scholarship granting organization."

This bill further provides conditions when the credit would be disallowed if a "qualified school" that accepts "educational scholarships" from a "scholarship granting organization" fail to comply.

On or before June 1 of each calendar year, this bill would require a "scholarship granting organization" to report to FTB the previous year's "educational scholarships" granted.

This bill would require the FTB to do the following:

- ➢ Promulgate any rules and regulations necessary to implement this bill.
- ➢ Provide a standardized format for a receipt to be issued by a "scholarship granting organization" to a "qualified taxpayer" to report the value of a received contribution. The FTB would require a "qualified taxpayer" to provide a copy of this receipt when claiming the credit.
- ➢ Provide a standardized format for the "scholarship granting organizations" to ensure the "educational scholarships" are not provided to "eligible students" to attend a "qualified school" with paid staff or board members, or relatives, in common with the "scholarship granting organization."
- ➢ Conduct a financial review or audit of a "scholarship granting organization" if in possession of evidence of fraud.
- ➢ Deny a "scholarship granting organization" from participating in the program if FTB establishes intentional and substantial noncompliance.
- ➢ Require FTB to notify any affected eligible student and his or her parent if a "scholarship granting organization" has been denied to participate in the program.
- ➢ Allow a "qualified taxpayer" to redirect a prorated share of state income tax withholdings to a "scholarship granting organization" of the "qualified taxpayer's choice", up to the maximum credit allowed, including carryover credits.

This bill would allow unused credits to be carried over for four years.

<u>IMPLEMENTATION CONSIDERATIONS</u>

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 disallow the credit for noncompliance by the scholarship granting organization or qualified school. This bill fails to specify who would measure and record whether the scholarship granting organization or qualified school are compliant. Further, it is unclear how the department or taxpayer would be notified of the noncompliance after receipt of the contribution has been provided. Typically, credits involving areas for which the department lacks expertise are certified by another agency or agencies that possess the relevant expertise. It is recommended that the bill be amended to provide certification language. 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.

This bill would allow a qualified taxpayer to divert a prorated share of state income tax withholdings to a scholarship granting organization. The department does not administer income tax withholding. If it is the author's intent to allow a taxpayer to divert withholding, it is recommended the bill be amended to authorize the Employment Development Department to administer this provision. If the author intends for FTB to administer this provision, it is recommended that the bill be amended to allow the taxpayer to divert income tax refunds or estimated tax payments instead of withholding.

The bill requires the scholarship entity to file financial information to demonstrate "financial viability" to FTB. It is unclear what the author intends for FTB to use to evaluate the viability or lack thereof of a scholarship entity. Similarly, if the entity fails to submit their viability information, they are required to submit a surety bond. In addition, the time requirement for the surety bond is unclear. The author may wish to amend the bill to clarify how this provision would operate to ease the administration of this bill.

In addition, the personal income tax (PIT) and corporation tax law (CTL) sections of this bill are inconsistent. There are several terms used and defined in the PIT section that do not apply when used in the CTL section, for example, "qualified taxpayer". Inconsistent terms and definitions could lead to disputes with taxpayers and would complicate the administration of this credit.

TECHNICAL CONSIDERATIONS

Amendments 1-5 have been provided to correct technical errors.

This bill specifies that the taxpayer is required to submit a copy of the contribution receipt when claiming the credit. Generally, FTB requires taxpayers to provide certification upon request to eliminate additional processing and storage issues. It is recommended that the bill be amended to require the contribution receipt be provided only on request. Department staff is available to work with the author's office in order to resolve this concern.

LEGISLATIVE HISTORY

AB 529 (Blumenfield, 2009/2010) would allow a deduction for contributions made to the Golden State Scholarshare Trust account. This bill is currently in the Assembly Rules Committee.

SB 30 (Speier, 2005/2006) would have allowed taxpayers to take a deduction for contributions made to a Golden State Scholarshare Trust Account. This bill failed passage out of the Senate Revenue and Taxation Committee.

OTHER STATES' INFORMATION

The states surveyed include *Florida, 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.

Florida has a corporate tax credit scholarship program known as the Step Up for Students. The tax credit allows corporations to receive a dollar-for-dollar tax credit of up to 75 percent of their state income tax liability for donations made to Scholarship Funding Organizations. *Florida* does not have personal income tax.

Illinois, Massachusetts, Michigan, Minnesota, and New York do not provide a credit comparable to the credit allowed by this bill.

FISCAL IMPACT

This bill would require a new credit form, a contribution form, and reporting conditions to FTB for the scholarship granting organization. As a result, this bill would impact the department's printing, processing and storage costs. The department's costs to administer this bill cannot be determined until the implementation concerns have been resolved. Once the implementation concerns have been resolved and the bill continues to move through the legislative process, costs will be identified and an appropriation will be requested, if necessary

ECONOMIC IMPACT

Revenue Estimate

This bill would result in the following revenue losses:

Estimated Revenue Impact AB 279 as Introduced on February 12, 2009, and Amended March 18, 2009 For Taxable Years Beginning On or After January 1, 2010 Enactment Assumed After June 30, 2009 ($ in Millions)			
Fiscal Year	2009-10	2010-11	2011-12
Revenue Loss	-$190	-$650	-$1,200

This analysis does not consider the possible changes in investment activity, 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 amount of annual contributions to scholarship granting organizations and the amount of credits qualified taxpayers would apply to reduce their tax liabilities.

This bill would provide an incentive for contributions to scholarship granting organizations by offering a dollar-for-dollar tax credit. In addition, taxpayers who itemize deductions would deduct the same contributions on both the federal and state tax returns as a charitable contribution. The proposed credit would be significant to alter a taxpayer's donation preference.

Department data for taxable year 2006 indicates contributions of cash and appreciated property reported on personal and corporate tax returns totaled approximately $40 billion. It is assumed that 10% of current contributions of cash and appreciated property would be redirected to scholarship granting organizations. The redirected contributions would total approximately

$4 billion a year ($40 billion cash and appreciated property contributions x 10% estimated contributions redirected).

In taxable year 2010, the initial year of the credit, it is assumed that contributions to scholarship granting organizations would total one-fifth or 20% of the potential $4 billion, or $800 million ($4 billion redirected contributions x 20% contributions to scholarship granting organizations). Applying this methodology to subsequent years, credits generated would increase $800 million each subsequent year until the $4 billion level is reached. By taxable year 2011, contributions to scholarship granting organizations would total approximately $1.6 billion ($800 million taxable year 2010 + $800 million taxable year 2011). Contributions are projected to increase in subsequent years to reflect growth in taxpayer awareness and the amount of contributions reported. It is assumed that the redirected contributions of $4 billion would be achieved in the fifth taxable year, or taxable year 2014.

Of the projected credits generated each year, it is assumed no more than one-half or $400 million would be applied in the year generated ($800 million contributions to scholarship granting organization x 50% estimated to be applied in the year generated). Carryover credits would be assumed applied equally over the next three years. Taxable year estimates would be converted to fiscal year cash flow estimates in the table.

The 2009-10 fiscal year cash flow estimates summarized above were calculated using the following detailed steps:

- Determined charitable contributions of cash and appreciated property reported on personal and corporate tax returns for the 2006 taxable year ≈ $40 billion.
- Assumed that 10% of total contributions would be eventually redirected ≈ $4 billion ($40 billion total charitable contributions x 10% estimated contributions redirected).
- Estimated redirected contributions equally over a five-year period ≈ $800 million ($4 billion redirected contributions x 20% estimate of contributions to scholarship granting organizations).
- Assumed 50% of credits would be applied in the year generated ≈ $400 million ($800 million contributions to scholarship granting organization x 50% estimated credit applied toward tax liability).
- Assumed 48% of the first year's impact would occur in the first six-months of 2010 to account for reduced cash flows from taxpayers anticipating reductions in their 2010 tax liabilities ≈ $190 million ($400 million credit generated x 48% first year's impact).

This estimate excludes the effect of re-characterizing tuition payments as donations. To the extent this would occur, there would be additional revenue losses.

POLICY CONCERNS

This bill would allow a credit for contributions made to a scholarship granting organization that are currently deductible. Generally, a credit is allowed in lieu of a deduction in order to eliminate multiple tax benefits for the same item of expense.

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

LEGISLATIVE STAFF CONTACT

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FRANCHISE TAX BOARD'S
PROPOSED AMENDMENTS TO AB 279
As Amended March 18, 2009

AMENDMENT 1

On page 5, line 31, strike "value" and insert:

amount

AMENDMENT 2

On page 5, lines 36, strike "(10)" and insert:

(9)

AMENDMENT 3

On page 6, line 6, strike "students" and insert:

student

AMENDMENT 4

On page 10, line 7, strike "value" and insert:

amount

AMENDMENT 5

On page 10, lines 12, strike "(10)" and insert:

(9)