**Franchise Tax Board**

# ANALYSIS OF ORIGINAL BILL

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| Author: | Beall | Analyst: | Brian Werking | Bill Number: | AB 1441 |
| Related Bills: | See Legislative History | Telephone: | 845-5103 | Introduced Date: | January 4, 2012 |
| | | Attorney: | Patrick Kusiak | Sponsor: | |

**SUBJECT**: Higher Education Costs Credit

## SUMMARY

This bill would provide a tax credit for qualified costs paid or incurred at the University of California, the California State University, or the California Community Colleges.

## RECOMMENDATION AND SUPPORTING ARGUMENTS

No position.

## PURPOSE OF THE BILL

According to the author, the purpose of this is bill is to provide some relief to middle-income Californians from the rising cost of higher education in the form of a tax credit.

## 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, 2012, and before January 1, 2017.

## 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.

Current federal law provides two types of education-related tax credits: the American Opportunity Credit and the Lifetime Learning Credit. The American Opportunity Credit allows a qualified taxpayer a credit of 100 percent for the first $2,000 of qualified tuition and related expenses, and a 25 percent credit for the next $2,000 of qualifying expenses, for a total tax credit of $2,500 each year per student. Up to 40 percent of the tax credit is refundable. The tax credit is phased out for a taxpayer with modified adjusted gross income between $80,000 and $90,000 for a single filer and between $160,000 and $180,000 for a joint filer. The tax credit may be claimed for an eligible student for only the first four years of postsecondary education.

| Board Position: | | | Executive Officer | Date |
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The Lifetime Learning Credit allows a taxpayer a nonrefundable credit of 20 percent of the first $10,000 of qualified tuition for a total of up to $2,000 per taxable year. The tax credit is phased out for a taxpayer with modified adjusted gross income between $51,000 and $61,000 for a single filer and between $102,000 and $122,000 for a joint filer. There is no limit to the number of taxable years that the tax credit may be claimed.

Current state law does not provide any education-related tax credits.

## THIS BILL

For taxable years beginning on or after January 1, 2012, and before January 1, 2017, this bill would provide a personal income tax credit of up to $500 per eligible student, per taxable year, for qualified costs paid or incurred by a qualified taxpayer at a qualified education institution. The aggregate amount of the credit for all taxable years per each eligible student would be $2,000. Any unused portion of the credit may not be carried over to a following tax year.

This bill would provide the following definitions:

- “Eligible student” would mean the taxpayer, the taxpayer’s spouse, or any dependent of the taxpayer.
- “Qualified costs” would mean tuition and fees required for enrollment or attendance of an eligible student at a qualified educational institution and expenditures for course materials.
- “Qualified taxpayer” would mean a taxpayer who pays or incurs qualified costs at any qualified educational institution during the taxable year and who has a modified adjusted gross income for that taxable year of at least $80,001 and not more than $140,000 for an individual or married persons filing joint returns.
- “Qualified educational institution” would mean the University of California, the California State University, or the California Community Colleges.
- “Course materials” would mean books, supplies, and equipment needed for a course of study, whether or not the materials are purchased from the qualified educational institution as a condition of enrollment or attendance.

This credit would be repealed as of December 1, 2017.

## 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.

The bill lacks a definition of “modified adjusted gross income,” which would be necessary to determine whether a taxpayer is a “qualified taxpayer.” The author may wish to specifically reference the definition of “adjusted gross income” under paragraph (2) of subdivision (h) of

Section 17024.5 of the Revenue and Taxation Code. Other credits, like the credit for household and dependant care,[1] have used this definition in computing income limitations for credits.

It is also unclear whether the bill excludes a taxpayer filing a return as a head of household, a surviving spouse, or married filing separately from qualifying for the credit. The author may wish to specifically include or exclude each filing status from eligibility for this credit.

It is unclear whether the $500 limitation refers to the maximum qualifying costs for each taxable year, or the maximum credit amount for each taxable year, or both. In addition it is unclear whether a qualifying taxpayer would be eligible for the credit for multiple years based on qualified costs incurred in a single tax year. The author may wish to specify the dollar limitation for the credit in terms of a dollar limitation the qualified costs paid or incurred by a qualifying taxpayer during a taxable year for an eligible student.

In addition, the phrase “books, supplies, and equipment needed for a course of study” should be defined to obtain certainty as to what would qualify as “course materials.” The absence of a definition to clarify this phrase could lead to disputes with taxpayers and would complicate the administration of this credit.

**LEGISLATIVE HISTORY**

AB 1079 (Beall, 2011/2012), similar to this bill, would have created a tax credit for qualified costs at the University of California or the California State University. This bill was held in the Assembly Revenue and Taxation Committee.

AB 1174 (Alquist, et. Al, 2001/2002) would have created a refundable tax credit for the costs of higher education. This bill was held in the Assembly Revenue and Taxation Committee.

AB 1441 (Wayne, 1997/1998) would have created a tax credit for university tuition and fees. This bill was held in the Assembly 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. With the exception of *New York*, none of these states provide a tax credit similar to that proposed by this bill.

*New York* provides a college tuition expenses tax credit of up to $400 per student, per year.

[1] Revenue and Taxation Code Section 17052.6

**FISCAL IMPACT**

If the implementation considerations discussed above are resolved, this bill would not significantly impact the department's costs.

**ECONOMIC IMPACT**

Revenue Estimate

This bill would result in the following revenue losses:

| Estimated Revenue Impact of AB1441<br>For Taxable Years Beginning On or After January 1, 2012<br>Enactment Assumed After June 30, 2012<br>($ in Millions) | | |
|---|---|---|
| 2012-13 | 2013-14 | 2014-15 |
| -$80 | -$50 | -$55 |

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

**SUPPORT/OPPOSITION**

Support: None provided.

Opposition: None provided.

**ARGUMENTS**

Pro: Some taxpayers could say that this bill is necessary to help offset the recent, unprecedented increases in the costs of college tuition.

Con: Some taxpayers could say that with the state's current fiscal crisis, additional tax expenditures should be avoided.

**Policy Concern**

This bill would allow a credit for an eligible taxpayer who had a modified adjusted gross income for the taxable year of at least $80,001 and not more than $140,000. This income limitation would apply equally to an eligible taxpayer filing as an individual or married filing jointly. The application of this income limitation regardless of filing status would create a "marriage penalty."[2] If the author intends to prevent this result, the author may wish to amend the language to equalize the tax treatment of married individuals/registered domestic partners filing separately and married individuals/registered domestic partners filing jointly.

**LEGISLATIVE STAFF CONTACT**

| | |
|---|---|
| Brian Werking | Patrice Gau-Johnson |
| Legislative Analyst, FTB | Asst. Legislative Director, FTB |
| (916) 845-5103 | (916) 845-5521 |
| brian.werking@ftb.ca.gov | patrice.gau-johnson@ftb.ca.gov |

[2] The "marriage penalty" refers to the higher tax liability of married two-worker couples, compared to their non-married counterparts. The "marriage penalty" was a consequence of the Revenue Act of 1948, when Congress abandoned treatment of the individual as the taxpayer unit and adopted the split-income plan of joint returns for married persons. (Pub. L. No. 471, Ch. 168, sections 301-305, 62 Stat. 110, 114-16 (codified as amended in scattered sections of 26 U.S.C.)).