Franchise Tax Board

ANALYSIS OF AMENDED BILL

Author:	Nestande	Analyst:	Jahna Carlson	Bill Number:	AB 2582
Related Bills:	See Legislative History	Telephone:	845-5683	Amended Dates:	March 29 & April 17, 2012
		Attorney:	Patrick Kusiak	Sponsor:	

SUBJECT: Credit For Contributions To Public Schools Or To An Educational Improvement Organization Supporting Innovative Cocurricular Programs

SUMMARY

This bill would establish the following income and franchise tax credits:

- A credit under the Personal Income Tax Law (PITL) and Corporation Tax Law (CTL) for monetary contributions to a public school for support of cocurricular activities, or to an educational improvement organization (EIO) that supports innovative programs in public schools.
- A credit under the CTL for monetary contributions to certain education scholarship granting organizations (ESGOs).

RECOMMENDATION

No position.

Summary of Amendments

The March 29, 2012, amendments removed the bill's provisions regarding legislative intent and replaced it with language that would create the income and franchise tax credits discussed in this analysis.

The April, 17, 2012, amendments added a specified operative date for the credits and modified the total amount of each credit that would be allowed.

This is the department's first analysis of this bill.

REASON FOR THE BILL

It appears that the reason for this bill is to encourage contributions to support innovative public school programs and corporate contributions to support scholarships by offering an income tax credit.

Board Position:			Department Director	Date
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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, 2015.

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.

Existing state and federal law defines "person" as including an individual, a trust, estate, partnership, association, company or corporation.[1] Under federal law, a taxpayer is any person subject to any internal revenue tax.[2] Under the state's PITL, a taxpayer is any individual, fiduciary, estate, or trust subject to the PITL or any partnership.[3]

Existing federal and state laws provide for five filing status types for individual filers: single, married filing jointly, married filing separately, head of household, and qualifying widow(er). Under California law the two status types that may apply to married individuals are also available to individuals in a Registered Domestic Partnership.

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

This bill would, for taxable years beginning on or after January 1, 2015, establish an income and franchise tax credit for contributions to a public school for support of cocurricular activities or to an educational improvement organization that supports innovative programs in public schools Cocurricular Activities and Innovative Programs (CAIP credit).

This bill would define the following terms for purposes of the CAIP credit:

- "Cocurricular activities" would mean activities for students that are optional, noncredit educational activities that supplement education, including, but not limited to, career and technical education, gifted programs, athletics, visual and performing arts, classroom enrichment, educational field trips, outdoor education, and tutoring. For purposes of this section, "support of cocurricular activities" excludes administrative or overhead costs.

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[1] Internal Revenue Code (IRC) section 7701(a)(1), Revenue and Taxation Code (R&TC) section 17007
[2] IRC section 7701(a)(14)
[3] R&TC section 17004

- "Educational improvement organization" or "EIO" would mean an organization that meets all of the following:
    - Is an organization that is exempt from federal income tax as an organization described in Section 501(c)(3) of the Internal Revenue Code.
    - Is an organization that contributes at least 80 percent of the contributions that it receives during a taxable year as grants to a public school for innovative programs. Grants may include cash payments to public schools to carry on innovative programs and may include costs incurred by the EIO in providing innovative programs to, or in conjunction with, public schools.
- "Innovative program" means a program that meets all of the following:
    - Is an advanced academic or similar program that is not part of the regular program of a public school, but enhances the curriculum of the public school.
    - Is targeted towards supporting innovative programs in science, technology, engineering, and math (STEM) literacy, and the arts for public schools.
    - Provides creative focus, delivery, including Internet-based and distance learning technologies, methodology, or skill training that is different than the academic program of the school.
- "Public school" means a public school, including a charter school, that provides instruction in kindergarten and grades 1 through 12, inclusive. For purposes of this section, the amount contributed for cocurricular activities must be made directly to the public school or public schools of the taxpayer's choice.

The amount of the CAIP credit would be equal to the monetary amount contributed during the taxable year by a taxpayer and subject to the following limitations:

- For taxpayers subject to the PITL, the maximum credit amount per taxable year would be $500 for a person making a separate return and $1,000 for persons making a joint return.
- For taxpayers subject to the CTL, the maximum credit would be limited to 50 percent of the taxpayer’s total tax liability before the allowance of this credit and not to exceed $300,000. The percentage would be increased to 75 percent if the amount contributed by the taxpayer in the preceding and current taxable year are at least 80 percent of the amount contributed in the taxable year that is two years prior to the current taxable year.

The total aggregate CAIP credit amount allowed would be limited to $500 million. This amount could be increased by 3 percent for any taxable year after 90 percent of the total amount of credit, as adjusted, has been allowed.

The CAIP credit would be allowed in addition to any deduction allowable.

CAIP credit amounts in excess of tax would be allowed to be carried forward for up to 5 years.

The Franchise Tax Board (FTB) would be authorized to promulgate rules and regulations as necessary or appropriate to implement the CAIP credit.

This bill would also create a credit under the CTL for contributions by a corporate taxpayer to an education scholarship granting organization that provides qualified tuition assistance to qualified students from moderate to low income families who attend a qualified school (ESGO credit).

This bill would define the following terms for purposes of the ESGO credit:

- Education scholarship granting organization or SGO would mean an organization that meets the following conditions:
    - Is an organization that is exempt from federal income tax as an organization described in Section 501(c)(3) of the Internal Revenue Code.
    - Uses at least 97 percent of amounts contributed during the taxable year for educational scholarships. Organizations that have less than three years of audits would be required to use 100 percent of contributions for educational scholarships.
    - Makes scholarships available for more than one school.
    - Submits to the state a financial and compliance audit performed by a certified public accountant and quarterly reports on the number of scholarships to recipients and the participating schools.
- Qualified school would mean a school that meets all of the following:
    - Is accredited.
    - Complies with the Health and Safety Code.
    - Complies with federal nondiscrimination requirements.
    - Requires teachers and other school personnel to have a background check.
    - Requires scholarship students to take a nationally recognized norm-referenced test or the state public school assessment.
    - Posts standardized test scores.
    - Provides financial reporting to the state.
    - If in operations less than three years, the school obtains a surety bond or letter of credit in an amount equal to the value of the scholarship payments for one quarter.
- Qualified student would mean an individual that meets all of the following conditions:
    - Family income does not exceed 300 percent of federal poverty guidelines.
    - Attended public school in the preceding school year or is entering kindergarten or first grade.
    - Is in kindergarten, or grades 1 to 12, inclusive.
- Qualified tuition would mean an amount that is 65 percent of the basic state per pupil funding, or selected school's tuition and fees, whichever is less.

The ESGO credit would be equal to the monetary amount contributed by a taxpayer during the taxable year, limited to 50 percent of a taxpayer's total tax liability, before allowance of this credit, up to a maximum of $300,000 per taxable year. The credit percentage would be increased from 50 percent to 75 percent if a taxpayer's contributions during the preceding and current taxable year are at least 80 percent of the amount contributed the year before the preceding taxable year.

The total aggregate amount of ESGO credits would be limited to $500 million. The limit could be increased by 3 percent in any taxable year after 90 percent of the total amount of credit, as adjusted, has been allowed.

Because this bill fails to specify otherwise, the ESGO credit would be allowed in addition to any deduction or credit allowable.

The bill fails to provide for carryover of unused ESGO credits to subsequent taxable years.

The FTB would be authorized to promulgate rules and regulations as necessary to implement the credit.

IMPLEMENTATION CONSIDERATIONS

Department staff has identified the following implementation considerations for purposes of a high level discussion; additional concerns may be identified as the bill moves through the legislative process. In order for the FTB to implement this bill, clarification is necessary for the following issues.

The bill lacks administrative details that must be determined to implement the bill and determine its impacts to the department's systems, forms, and processes. For example, the bill is silent on the following issues:

- Would the total aggregate credit amount limitation be applied on an annual basis, or over the life of the credit? If on an annual basis, would the period be a fiscal year? Taxable year? Calendar year?
- How would credits reported on a return other than a timely-filed, original return affect the calculation of the aggregate total? Would credits disallowed, for example, as a result of an audit, trigger a recalculation of the aggregate total?
- How would the aggregate total amount of contributions be tracked and by whom? Would the information be made available to the public? How, by whom, and when?
- How, by whom, and when would the determination be made that the total allowable credit would be increased by the additional 3 percent this bill would allow? Would notification of the increase be publicized? How, by whom, and when?
- How would claimed credits in excess of the aggregate total be treated?
- What type of audit, conducted by whom, and what three year period applies would an education scholarship granting organization be subject to?

It is recommended that the bill be amended to clarify these conditions and rules to eliminate confusion as to the author's intentions.

It is unclear whether the CAIP credit is intended to be available to all taxpayers subject to the PITL (including both individuals and certain business entities such as partnerships and limited liability companies) or limited to individuals because the bill uses the term "person."[4] Lack of clarity could lead to disputes with taxpayers and would complicate the administration of this credit.

[4] The term "persons" is broadly defined by statute and includes individuals, trusts, and pass-thru entities subject to tax under the PITL. IRC section 7701(a)(1) and R&TC section 17007.

A corporate taxpayer, for the first two years the credits would be available, would be required to "look back" to taxable years prior to the credits' availability to determine whether the enhanced credit percentage applied. This could increase the administrative burden on both the taxpayer and the department. The author may wish to amend this bill to eliminate the "look back" to pre-credit taxable years to provide for ease of administration.

As defined, public schools and qualified school for purposes of the ESGO credit would include schools that are located both within and outside of California. If this is contrary to the author's intent, this bill should be amended.

This bill uses phrases that are undefined, e.g., "carry on innovative programs," "classroom enrichment," "costs incurred by the organization in providing innovative programs to, or in conjunction with, public schools,""educational scholarship," "enhances the curriculum," "monetary amount," "outdoor education," "provides creative focus," "supplement education," "support of cocurricular activities," "supports innovative programs." Additionally, the definition of the term "cocurricular activities" is broad and open to interpretation. The absence of definitions to clarify these terms could lead to disputes with taxpayers and would complicate the administration of this credit.

The department lacks the data and the expertise to determine whether an organization would qualify as an "educational improvement organization" or an "educational scholarship granting organization." Typically, credits involving areas for which the department lacks expertise are certified by another agency or agencies that possess the relevant expertise. The certification language would specify the responsibilities of both the certifying agency and the taxpayer.

A certified credit that is specifically allocated by another agency could also eliminate any uncertainty as to the availability of the credit. For example, because the credits would be allowed based on the filing of a return claiming the credit rather than the date a contribution is made, a taxpayer that made the earliest contribution during a taxable year could be denied the credit if the aggregate total credit amount had been reached at the time the taxpayer filed that year's return. Uncertain tax consequences could lead to disputes between taxpayers and the department. If this is contrary to the author's intent, the author may wish to consider a credit that is certified at the time a contribution is made.

TECHNICAL CONSIDERATIONS

On page 2, line 26, and page 4, line 23, the word "all" should be replaced with the word "both" to correct a grammatical error.

On page 2, line 34, page 4, line 31, the acronym "EIO" should be replaced with the word "organization" to correspond with existing terminology.

The language that would allow the credit in addition to any allowable deductions is unnecessary since existing state law already provides this result. On page 3, delete lines 25 and 26, and on page 5, delete lines 19 and 20.

On page 7, line 13, the phrase "or appropriated" should be replaced with the phrase "or appropriate" to correct a grammar error and correspond with existing terminology.

LEGISLATIVE HISTORY

AB 1542 (Negrete-McLeod, 2011/2012) would create an income tax credit for contributions made to a local educational advancement program (LEAP) organization. The credits AB 2582 would create would be calculated and subject to limitations similar to the calculation and limitations of AB 1542. AB 1542 is pending before the Assembly Revenue and Taxation Committee.

AB 279 (Duvall, 2009/2010) would have created an income tax credit for contributions to a scholarship granting organization. AB 279 failed passage out of the Assembly Revenue and Taxation Committee.

AB 1262 (Haynes, 2005/2006) would have created a 75 percent credit for donations to a nonprofit organization that provides scholarships to elementary and secondary school students. The bill failed passage out of 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.

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 a 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

Because the bill is silent on a number of administrative questions, the department's costs to administer this bill are unable to be determined until implementation concerns have been resolved. As the bill continues to move through the legislative process and implementation concerns are resolved, costs will be identified and an appropriation will be requested, if necessary.

ECONOMIC IMPACT

<u>Revenue Estimate</u>

Estimated Revenue Impact of AB 2582 For Taxable Years Beginning On or After January 1, 2015 Assumed Enactment After June 30, 2012 ($ in Millions)					
2012-13	2013-14	2014-15	2015-16	2016-17	2017-18
-$0	-$0	-$235	-$585	-$285	-$168

Due to the operative date of the bill, the revenue table has been expanded to show an additional three years of revenue loss as a result of this bill.

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

SUPPORT/OPPOSITION[5]

Support: None identified.

Opposition: None identified.

ARGUMENTS

Proponents: Some could argue that this credit would provide funding to support enhanced educational opportunities for grades kindergarten through 12 in the public schools.

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

POLICY CONCERNS

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

The credit would be allowed for contributions to public schools, EIOs, or educational scholarship granting organizations located inside and outside California.

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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[5] As reported on the Legislative Counsel's website at <http://leginfo.legislature.ca.gov/faces/billNavClient.xhtml?bill_id=201120120AB2582&search_keywords=>[as of May 3, 2012].