

ANALYSIS OF AMENDED BILL

Franchise Tax Board

Author: Olsen, et al. Analyst: Michelle Chan Bill Number: AB 1786
Related Bills: See Legislative History Telephone: 845-6805 Amended Date: April 1, 2014
Attorney: Bruce Langston Sponsor: _____

SUBJECT: Education-Related Expenses Deduction

SUMMARY

This bill would, under the Personal Income Tax Law, allow a deduction from gross income for certain education-related expenses.

RECOMMENDATION

No position.

Summary of Amendments

The April 1, 2014, amendments removed the bill's legislative intent language, added a co-author, and added the provisions discussed in this analysis. This is the department's first analysis of the bill.

Summary of Suggested Amendments

An amendment is suggested to resolve a technical concern.

REASON FOR THE BILL

The reason for this bill is to ease the financial burden of providing a high-quality K-12 education on low and middle income parents.

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, and before January 1, 2020.

ANALYSIS

FEDERAL/STATE LAW

Existing federal and state laws provide that gross income includes all income from whatever source derived, including compensation for services, business income, gains from property, interest, dividends, rents, and royalties, unless specifically excluded.

Board Position:

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Executive Officer

Date

Selvi Stanislaus

5/6/14

Existing federal and state laws provide that certain types of income are excluded from gross income, such as amounts received as a gift or inheritance, certain compensation for injuries and sickness, qualified scholarships, educational assistance programs, foster care payments, and interest received on certain state or federal obligations. These are items that the taxpayer has received as economic benefits, but have been specifically excluded by law.

Existing federal and state laws allow individuals to deduct certain expenses, such as medical expenses, charitable contributions, interest, and taxes, as itemized deductions. Certain other expenses for the production of income and certain employee business expenses are considered miscellaneous itemized deductions.¹ Also, itemized deductions may be further limited for high-income taxpayers.

Existing federal and state laws allow for the deduction of certain expenses when calculating adjusted gross income, such as moving expenses and interest on education loans, certain ordinary and necessary trade and business expenses, losses from the sale or exchange of certain property, contributions for pension, profit-sharing and annuity plans of self employed individuals, retirement savings, and alimony. Thus, all taxpayers with these types of expenses receive the benefit of the deduction, regardless of whether the taxpayer itemizes deductions or uses the standard deduction. These are known as “above-the-line” deductions.

There are currently no federal or state deductions from gross income comparable to the deduction that this bill would create.

THIS BILL

This bill would, for taxable years beginning on or after January 1, 2015, and before January 1, 2020, allow a deduction an amount equal to the qualified amount that was paid or incurred for qualified education-related expenses for one or more dependent children by a qualified taxpayer during the taxable year, not to exceed \$2,500 in a taxable year. If a deduction is allowed to more than one qualified taxpayer for a dependent child, the total combined deduction amount allowed under this bill cannot exceed \$2,500 in a taxable year.

This bill would define the following terms and phrases:

- “Dependent children” means children who attend kindergarten or any of grades 1 to 12, inclusive, in California at a public, charter, or private school that has a current private school affidavit on file with the State Department of Education in the taxable year and who meet the requirements of Section 152(c)(1)(D) and (E) of the Internal Revenue Code (IRC).²
- “Qualified amount” means the amount paid or incurred for qualified education-related expenses, not to exceed \$2,500.
- “Qualified education-related expenses” means the kindergarten or any of grades 1 to 12, inclusive, costs of: textbooks and school supplies, including, but not limited to, pens, paper, pencils, notebooks, calculators, and rulers; the rental or purchase of educational

¹ Only the portion that exceeds 2% of adjusted gross income may be deducted.

² The term qualifying child under this section means, an individual, who hasn't provided over one-half of his or her own support for the calendar year, and who must be younger than the claimant and be unmarried; qualifying child benefits restricted to child's parents.

equipment required for classes during the regular school day; school uniforms that are not part of a cocurricular activity; computers, computer hardware, and educational computer software used to learn academic subjects; fees for college courses at public institutions or independent nonprofit colleges, or for summer school courses that satisfy high school graduation requirements; psychoeducational diagnostic evaluations to assess the cognitive and academic abilities of pupils; special education and related services for pupils who have an individualized education program or its equivalent; out-of-school enrichment programs, tutoring, and summer programs that are academic in nature; and public transportation or third-party transportation expenses for traveling directly to and from school.

Expenses for items that are used in a trade or business would be specifically excluded from the definition of “qualified education-related expenses.”

- “Qualified taxpayer” means a parent or legal guardian of a full-time pupil who is under 21 years of age at the close of the school year who meets both of the following requirements:
 - Both the pupil and the parent or guardian resides in California when the qualified education-related expenses are paid or incurred.
 - The household income does not exceed 300 percent of the federal Income Eligibility Guidelines published by the Food and Nutrition Service of the United States Department of Agriculture for use in determining eligibility for reduced price meals.
- “Household income” means gross income defined in Section 61 of the Internal Revenue Code.³

The Franchise Tax Board (FTB) would have the authority to prescribe rules, guidelines or procedures necessary or appropriate to carry out the provisions of the bill. These rules, guidelines, or procedures would be exempt from the normal rulemaking requirements of the Administrative Procedures Act.

This provision would be repealed by its own terms as of December 1, 2020.

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.

This bill provides that if a deduction is allowed to more than one qualified taxpayer for the same dependent child, the total combined deduction amount allowed under this bill cannot exceed \$2,500 per taxable year. It is unlikely that the parents or guardians would be aware of the other's qualified expenses, and at the time returns are being processed, the department would be unable to determine if the taxpayers had exceeded the total combined limit of the deduction amount. To avoid conflicts between taxpayers and the department, the bill should be amended.

³ Gross income under this section means all income from whatever source derived, including (but not limited to) compensation for services, business income, gains from property, interest, dividends, rents, and royalties, unless specifically excluded.

This bill uses terms that are undefined, i.e., “parent or legal guardian” and “full-time pupil.” The absence of definitions to clarify these terms could lead to disputes with taxpayers and would complicate the administration of this deduction.

TECHNICAL CONSIDERATIONS

Amendment 1 is suggested to make a minor technical correction.

LEGISLATIVE HISTORY

AB 819 (Runner, 2007/2008) and SB 643 (Florez, 2007/2008) would have allowed a deduction for contributions made by a qualified taxpayer to certain qualified tuition programs. AB 819 failed passage out of the Assembly Revenue and Taxation Committee and SB 643 failed passage out of the Senate Governance and Finance 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. Except for *Minnesota*, none of these states provide a deduction comparable to the deduction proposed by this bill.

Minnesota allows a subtraction from taxable income for certain education-related expenses for a qualifying child in kindergarten through grade 12 (K-12). The maximum subtraction that can be claimed is \$1,625 per qualifying child in grades K through 6 and \$2,500 for a qualifying child in grades 7 through 12.

FISCAL IMPACT

Costs have not been determined at this time. As the bill continues to move through the legislative process and the implementation concerns are resolved, costs will be identified and an appropriation will be requested, if necessary.

ECONOMIC IMPACT

Revenue Estimate

Estimated Revenue Impact of AB 1786 As Amended April 1, 2014 Assumed Enactment After June 30, 2014 (\$ in Millions)		
2015-16	2016-17	2017-18
- \$40	- \$41	- \$43

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

Proponents: Supporters could argue that this bill would provide some needed financial assistance to parents who reach into their own pockets to fund vital education resources and services.

Opponents: Some could argue that while providing a tax incentive for parents to assist with expenses associated with educating the state's children, this bill would result in revenue losses, which have to be paid for with higher taxes on others or reductions in services.

POLICY CONCERNS

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

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FRANCHISE TAX BOARD'S
PROPOSED AMENDMENTS TO AB 1786
AS AMENDED APRIL 1, 2014

AMENDMENT 1

On page 4, strikeout lines 18 through 21 inclusive, and insert:

“(d) Section (62)(a) of the Internal Revenue Code is modified to provide that the deduction under Section 17052.5 shall be allowed in determining adjusted gross income.”