ANALYSIS OF ORIGINAL BILL

Franchise Tax Board

Author:	Bonilla	Analyst:	Jane Raboy	Bill Number:	AB 1956
Related Bills:	See Legislative History	Telephone:	845-5718	Introduced Date:	February 19, 2014
		Attorney:	Bruce Langston	Sponsor:	

SUBJECT: Contributions to Qualified Tuition Plan Account Refundable Credit

SUMMARY

This bill would create a refundable credit for contributions to a California Scholarshare qualified tuition plan account under the Personal Income Tax Law (PITL).

RECOMMENDATION

No position.

REASON FOR THE BILL

The reason for the bill is to encourage taxpayers to invest for future higher education expenses and reduce student debt by providing tax relief for college savings.

EFFECTIVE/OPERATIVE DATE

This bill would be effective January 1, 2015, and specifically operative for taxable years beginning on or after January 1, 2014.

ANALYSIS

PROGRAM BACKGROUND

Internal Revenue Code (IRC) section 529 provides specified income tax rules for the treatment of accounts and contracts established as qualified tuition programs.[1] A qualified tuition program is a program established and maintained by a state or agency or instrumentality thereof, or by one or more eligible educational institutions, which satisfies certain requirements and under which a person may purchase tuition credits or certificates on behalf of a designated beneficiary that entitle the beneficiary to the waiver or payment of qualified higher education expenses of the beneficiary (a "prepaid tuition program"). In the case of a program established and maintained by a state or agency or instrumentality thereof, a qualified tuition program also includes a program

[1] For purposes of this description, the term "account" is used interchangeably to refer to a prepaid tuition benefit contract or a tuition savings account established pursuant to a qualified tuition program.

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under which a person may make contributions to an account that is established for the purpose of satisfying the qualified higher education expenses of the designated beneficiary of the account, provided it satisfies certain specified requirements (a “savings account program”). Under both types of qualified tuition programs, a contributor establishes an account for the benefit of a particular designated beneficiary to provide for that beneficiary’s higher education expenses.

California conforms to IRC section 529 as of the “specified date” of January 1, 2009, with general state modifications, and thus generally conforms to the federal rules that apply to qualified tuition programs.[2] California modifies the additional 10-percent tax on excess distributions to instead be an additional tax of 2.5 percent for state purposes.[3]

California has its own IRC section 529 qualified tuition program, the Golden State Scholarshare Trust, commonly referred to as “ScholarShare.”[4] ScholarShare is a higher education expense prepayment program that allows purchasers to pay in advance for a designated beneficiary’s educational costs at a participating institution.

ScholarShare generally exempts from taxation the earnings from the trust at the time they are earned, provides that distributions in excess of amounts contributed (such as interest earnings) are included in the gross income of the designated beneficiary at the time the distributions are made, and provides that the furnishing of education to a designated beneficiary is considered a distribution. If a ScholarShare distribution exceeds the qualified higher education expenses incurred for the beneficiary, the portion of the excess that is treated as earnings generally is subject to income tax and an additional 2.5-percent tax for state purposes.[5]

Parents, grandparents, relatives, and friends who are U.S. citizens or resident aliens and at least 18 years of age may open an account and contribute to ScholarShare on behalf of a beneficiary. ScholarShare funds can be used at eligible schools nationwide and many abroad, and funds can be used for tuition, mandatory fees, books, supplies, and equipment required for enrollment or attendance, certain room and board costs, and certain expenses for "special needs" students.

ScholarShare accounts have no income limitations, and contributors can contribute as much as $371,000 per beneficiary account as long the total balance of all accounts for that beneficiary does not exceed $371,000. Accounts that have reached the maximum account balance limit may continue to accrue earnings.

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[2] Revenue and Taxation Code (R&TC) sections 17140.3 and 23711.

[3] R&TC section 17085(c)(1).

[4] R&TC sections 17140, 23711.5, and 24306. The Golden State Scholarshare Trust was designed to meet the requirements of Internal Revenue Code section 529 as a qualified tuition program, see Section 7 of Chapter 851 of the Statutes of 1997 (AB 530).

[5] The additional tax is 10 percent for federal purposes.

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.

There are currently no federal or state credits comparable to the credit this bill would create.

THIS BILL

For taxable years beginning on or after January 1, 2014, this bill would allow a refundable credit in the amount of 20 percent of the monetary contributions made by a qualified taxpayer to a qualified tuition plan account that the qualified taxpayer owns during the taxable year, not to exceed $500 per return.

This bill would define the following phrases:

- "Nonqualified withdrawal" means a withdrawal of funds from a qualified tuition plan account for purposes that are not qualified higher education expenses, as defined in Section 529 of the Internal Revenue Code.
- "Qualified taxpayer" means an individual who, on behalf of a beneficiary, contributes money to a qualified tuition plan account for which the individual is the account owner and has one of the following annual adjusted gross incomes:
    - If the qualified taxpayer's filing status is single, married, or domestic registered partner filing separately, $100,000 or less.
    - If the qualified taxpayer files as a head of household, surviving spouse, as defined in Section 17046, married filing jointly, or domestic partner filing jointly, $200,000 or less.
- "Qualified tuition plan" means a qualified tuition program, as defined in Section 529 of the Internal Revenue Code, and established pursuant to the Golden State Scholarshare Trust Act.[6] .
- "Qualified tuition plan account" means an account, described in Section 529(b)(1)(A)(ii)[7] of the Internal Revenue Code.

In the case of married taxpayers or registered domestic partners who file separate returns, the credit may be taken by either spouse or registered domestic partner or divided equally between the spouses or registered domestic partners.

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[6] Article 19 (commencing with Section 69980) of Chapter 2 of Part 42 of Division 5 of Title 3 of the Education Code.
[7] An account which is established for the purpose of meeting the qualified higher education expenses of the designated beneficiary of the account.

This bill would require a 10 percent recapture of any nonqualified withdrawals from a qualified tuition plan account for which the credit has been claimed, up to a maximum of the total credits received.

The Scholarshare Investment Board would be required to verify the amount of the contribution made and the name of the accountholder for the Franchise Tax Board (FTB).

Upon an appropriation by the Legislature, the portion of any credit allowed that is in excess of tax liability, would be required to be paid to the taxpayer.

This bill would authorize the FTB to prescribe rules, guidelines, or procedures necessary or appropriate to administer the credit.

Any standard, criterion, procedure, determination, rule, notice, or guidelines established or issued by the FTB would be exempt from the Administrative Procedures Act.[8]

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 would require regular annual appropriations by the Legislature to pay for the refundable portion of this credit. If sufficient funds fail to be appropriated to cover all of the refunds due, the department would suspend payment of the refunds until additional funds were appropriated. Interest would have to be paid to refund recipients for the period the refund was delayed. This delay would result in additional contacts to the department by refund recipients, which would likely increase departmental costs.

The FTB does not currently administer a refundable tax credit under the PITL. Establishing a refundable tax credit program would have a significant impact on the department's forms and systems. Additionally, the department's experience administering refundable PITL credits indicates that the cost to detect fraudulent refund claims would be significant. Staff is available to work with the author to establish a matching mechanism to detect fraudulent refund claims at the time a return is filed and before a refund is made.

It is unclear if the author's intent is to limit the credit amount to $500 per return, or to limit the monetary contribution to $500 per return, resulting in a $100 credit. The author may wish to amend this bill for clarity and to avoid disputes between individuals and the department.

The bill lacks the specific language that would allow the department to apply the refundable portion of the credit for a tax year against other amounts due from a taxpayer for another tax year. Absent this language, monies may be refunded even though a liability is due by the taxpayer.

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[8] Chapter 3.5 (commencing with Section 11340) of Part 1 of Division 3 of Title 2 of the Government Code.

<u>TECHNICAL CONSIDERATIONS</u>

The language on page 2, lines 15 through 18, and page 2, lines 26 through 29, includes a reference to registered domestic partners that is unnecessary since existing state law provides this general rule. The references to registered domestic partners should be deleted. Amendments 1 through 5 would remove this language.

LEGISLATIVE HISTORY

AB 26 (Nation, 2001/2002), would have established a refundable tax credit of up to $500 for contributions to Scholarshare accounts. AB 26 failed to pass the Assembly Revenue and Taxation Committee.

SB 44 (Alpert, 2001/2002), a similar bill, would have established a refundable tax credit of up to $500 for each beneficiary on whose behalf an individual makes a contribution to a Scholarshare trust. SB 44 failed to pass the Assembly Revenue and Taxation Committee.

SB 782 (Brulte, et al, 2001/2002), a substantially similar bill, would have established a refundable tax credit of up to $500 for contributions to Scholarshare accounts. SB 782 failed to pass the Assembly Revenue and Taxation Committee.

OTHER STATES' INFORMATION

Florida, Illinois, Massachusetts, Michigan, Minnesota, and *New York* laws do not provide a credit comparable to the credit allowed by this bill. These states were selected due to their similarities to California's economy, business entity types, and tax laws.

FISCAL IMPACT

The FTB does not currently administer a refundable tax credit under the PITL or the Corporation Tax Law. Establishing a refundable tax credit program would have a significant impact on the department's programs and operations and require extensive changes to forms and systems. As the bill continues to move through the legislative process, costs will be identified and an appropriation will be requested, if necessary.

ECONOMIC IMPACT

<u>Revenue Estimate</u>

Estimated Revenue Impact of AB 1956 As Introduced February 19, 2014 For Taxable Years Beginning On or After January 1, 2014 Assumed Enactment After June 30, 2014 ($ in Millions)		
2014-15	2015-16	2016-17
- $37	- $39	- $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

Proponents: Supporters may argue that this bill would bolster economic activity within the state by decreasing the educational debt carried by post-secondary school students and their families.

Opponents: Some may argue that this bill would have a negligible impact on economic growth and may have undesirable consequences for students who would otherwise be eligible to receive financial aid.

POLICY CONCERNS

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

This bill would provide a tax benefit for an individual that contributes to the California Scholarshare that would not be provided to other individuals contributing to a different qualified tuition plan account. Thus, this bill would provide differing treatment based solely on the type of prepayment program.

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FRANCHISE TAX BOARD'S
PROPOSED AMENDMENTS TO AB 1956
AS INTRODUCED FEBRUARY 19, 2014

AMENDMENT 1

On page 2, lines 12 and 13, strikeout "single, married, or domestic registered partner" and insert:

single or married

AMENDMENT 2

On page 2, line 16 and 17, strikeout "married filing jointly, or domestic partner" and insert:

or married

AMENDMENT 3

On page 2, lines 26 and 27, strikeout "or domestic partners".

AMENDMENT 4

On page 2, lines 28, strikeout "or registered domestic partner".

AMENDMENT 5

On page 2, lines 29, strikeout "or registered domestic partners".