Franchise Tax Board

ANALYSIS OF AMENDED BILL

Author:	Bonilla, et al.	Analyst:	Jane Raboy	Bill Number:	AB 1956
Related Bills:	See Legislative History	Telephone:	845-5718	Amended Date:	April 1, 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.

RECOMMENDATION

No position.

Summary of Amendments

The April 1, 2014, amendments added several co-authors, made several substantive and technical changes, revised the definition of numerous terms, modified the bill's operative date, eliminated the Scholarshare Investment Board responsibility to verify the qualified contribution and account information for the Franchise Tax Board (FTB), and broadened the tax credit to include all qualified tuition programs.

This analysis replaces the department's analysis of the bill as introduced February 19, 2014.

Summary of Suggested Amendments

Amendments 1 through 6, are suggested to clarify terms, and provide for consistent use of terminology.

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

As a tax levy, this bill would be effective immediately upon enactment and operative for taxable years beginning on or after January 1, 2015.

Board Position:			Executive Officer	Date
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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. 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 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. California modifies the additional 10-percent tax on excess distributions to instead be an additional tax of 2.5 percent for state purposes.

California has its own IRC section 529 qualified tuition program, the Golden State Scholarshare Trust, commonly referred to as “ScholarShare.” 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.

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.

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, 2015, this bill would allow a credit equal to the lesser of 20 percent of the monetary contributions made by a qualified taxpayer to a qualified tuition program that the qualified taxpayer owns during the taxable year, or $500.

This bill would define the following phrases:

- “Nonqualified withdrawal” means any payment or distribution from a qualified tuition program that is subject to additional tax pursuant to Section 529(c)(6) of the Internal Revenue Code (IRC), relating to additional tax (on distributions not used for educational expenses).
- “Qualified taxpayer” means an individual who, on behalf of a beneficiary, contributes money to a qualified tuition program 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 filing separately, 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 program” means a qualified tuition program, as defined in Section 529 of the IRC.

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.

An additional tax would be imposed on a qualified taxpayer who receives a nonqualified withdrawal in an amount that is the lesser of:

- 10 percent of that nonqualified withdrawal, or
- The total credit amount allowed for the current taxable year and all prior taxable years that the qualified taxpayer was allowed a credit.

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 qualified 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.[1]

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 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. Furthermore, absent a carryover provision in this bill, the taxpayer would be unable to claim the refund in subsequent years.

The FTB does not currently administer a refundable tax credit. Establishing a refundable tax credit program would have a significant impact on the department's forms, processes, and systems. Additionally, the department's experience administering refundable credits indicates that the cost to detect fraudulent refund claims would be significant.

With the exception of contributions to the California Scholarshare program, it is unclear how the department could verify the amount contributed by a non-resident of California and that the contributions were made to a qualified tuition program.

The bill lacks 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 owed by the taxpayer.

TECHNICAL CONSIDERATIONS

The phrase on page 2, lines 12 to 13, "qualified tuition program that the qualified taxpayer owns during the taxable year" is inconsistent with the definition of qualified taxpayer. Amendment 1 would correct the inconsistency.

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

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. Amendments 2 through 5 would remove the unnecessary 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), similar to this 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. 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.

Department staff is unable to determine the costs to administer this bill until the implementation concerns have been resolved, but anticipate the costs to be significant.

ECONOMIC IMPACT

<u>Revenue Estimate</u>

This proposal would allow any account owner, regardless of whether they have a filing requirement in California, to file for a refundable tax credit based on contributions to their 529 plan. Once fully implemented, revenue loss is estimated at $800 million per year.

SUPPORT/OPPOSITION[2]

Support: Bill Lockyer, California State Treasurer (Sponsor), California Association of Private School Organizations, California Catholic Conference, Corporation for Enterprise Development Financial Services Institute, Greenlining Institute, National Association of Insurance Advisors-California, and State Farm Mutual Automobile Insurance Company.

Opposition: California Taxpayers Association, and California Teachers Association.

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 be too costly for the state to administer and would have an undesirable consequence on 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.

Eligibility for the refundable credit would include (1) individuals that are located outside of the state and (2) individuals that contribute to another state's 529 plan. For example, if an Ohio resident contributes to an Ohio 529 plan, the Ohio resident could file a tax return in California requesting a refund for the contribution to the 529 plan even though the Ohio resident has no nexus in California. Providing a refundable credit for activity that has no connection to the state is unprecedented and would be costly to California.

This bill fails to limit the amount of the credit that may be taken. Credits that could potentially be quite costly are sometimes limited to a maximum aggregate amount per taxable year.

LEGISLATIVE STAFF CONTACT

Jane Raboy	Mandy Hayes	Jahna Carlson
Legislative Analyst, FTB	Revenue Manager, FTB	Asst. Legislative Director, FTB
(916) 845-5718	(916) 845-5125	(916) 845-5683
jane.raboy@ftb.ca.gov	mandy.hayes@ftb.ca.gov	jahna.carlson@ftb.ca.gov

[2] As noted in the Assembly Revenue and Taxation Committee bill analysis hearing date April 7, 2014.

Analyst	Jane Raboy
Telephone #	(916) 845-5718
Attorney	Bruce Langston

FRANCHISE TAX BOARD'S
PROPOSED AMENDMENTS TO AB 1956
AS AMENDED APRIL 1, 2014

AMENDMENT 1

On page 2, lines 12 - 13, strikeout “that the qualified taxpayer owns” and insert:

for which the individual is the account owner

AMENDMENT 2

On page 2, lines 27 - 28, strikeout “single, married filing separately, or domestic registered partner” and insert:

single or married

AMENDMENT 3

On page 2, lines 31 - 32, strikeout “married filing jointly, or domestic partner" and insert:

or married

AMENDMENT 4

On page 3, lines 1 - 2, strikeout “or registered domestic partners".

AMENDMENT 5

On page 3, line 3, strikeout "or registered domestic partner”.

AMENDMENT 6

On page 3, line 4, strikeout "or registered domestic partners”.