

# ANALYSIS OF AMENDED BILL

## Franchise Tax Board

Author: Nestande and Allen Analyst: Diane Deatherage Bill Number: AB 2422  
Related Bills: See Legislative History Telephone: 845-4783 Amended Date: April 1, 2014  
Attorney: Bruce Langston Sponsor: \_\_\_\_\_

**SUBJECT:** Contributions to Nonprofit Education Improvement Organization Credit

### SUMMARY

This bill would create a tax credit for monetary contributions to nonprofit education improvement organizations under the Corporation Tax Law (CTL).

### RECOMMENDATION

No position.

### Summary of Amendments

The April 1, 2014, amendments added a coauthor and replaced the bill's intent language with the provisions discussed in this analysis. This is the department's first analysis of the bill. This analysis only addresses the provisions of this bill that impact the department's programs and operations.

### REASON FOR THE BILL

The reason for this bill is to encourage contributions to support innovative private, public, and charter school programs by offering an income 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, 2015, and before January 1, 2020.

### 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.

Board Position:

\_\_\_\_\_ S      \_\_\_\_\_ NA        X   NP  
\_\_\_\_\_ SA      \_\_\_\_\_ O      \_\_\_\_\_ NAR  
\_\_\_\_\_ N      \_\_\_\_\_ OUA

Executive Officer

Date

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Current state and federal laws generally allow taxpayers engaged in a trade or business to deduct all expenses that are considered ordinary and necessary in conducting that trade or business.

Existing state and federal laws allow deductions from income for charitable contributions. The charitable contribution deduction for a corporation is limited to the adjusted basis of the property being contributed. In addition, the amount a corporation can deduct for a charitable contribution in a given year is limited to 10 percent of the corporation's net income. A contribution made by either an individual or a business in excess of the percentage limitations may be carried over and deducted in future years.

### THIS BILL

This bill would create a tax credit under the CTL equal to 50 percent of the monetary contribution made during the taxable year by a taxpayer to a nonprofit education improvement organization (EIO) to fund a qualified grant for a K-12 education innovative program for pupils attending private, public, or charter schools.

The following requirements would apply to the credit:

- The tax credit could not exceed \$200,000 per taxpayer per taxable year.
- A taxpayer would be required to receive certification from the Franchise Tax Board (FTB) that a contribution meets the requirements of this bill and to apply with the FTB to receive a credit.
- An EIO would be required to apply with the FTB to receive a qualified grant.
- Any unused tax credit could be carried forward up to six years, until the credit is exhausted.
- The tax credit would be in lieu of any other credit or deduction claimed by a taxpayer for contributions made to a nonprofit EIO.
- The tax credit must be claimed on a timely filed original return.

The aggregate credit amount allowed would be limited to a maximum of \$50 million for each calendar year and the allocation of the credits would be on a first-come, first-serve basis. The Legislature would be authorized to increase the aggregate amount of the credits allowed.

This bill would authorize the FTB and the State Department of Education to administer this tax credit.

The FTB would be required to do the following:

- Promulgate rules and regulations as necessary or appropriate to implement the credit.
- Establish application forms and procedures.
- Track credits claimed.
- Post aggregate totals of the credit claimed on the department's Internet Web.
- Determine when the aggregate total of credit reaches \$50 million for a calendar year.
- Certify that the contributions meet the requirements for the tax credit.

The State Department of Education would be required to do the following:

- Adopt rules necessary to determine whether an EIO and a contribution meet the requirements of the bill; and
- Submit a list of EIOs annually to the FTB, by March 15.

The bill provides definitions for various terms including “charter school,” “education improvement organization,” “nonprofit,” “qualified grant,” and “K-12 education innovation program,” “private school,” “public school,” and “charter school.”

The rules, guidelines, and procedures established by the FTB and the State Department of Education would be exempt from the regulatory requirements of the Administrative Procedures Act.<sup>1</sup>

The credit would be repealed by its own terms on December 1, 2020.

### 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. Department staff is available to work with the author’s office to resolve these and other concerns that may be identified.

This bill lacks specificity on the eligibility requirements and administration of the tax credit. For example, the credit lacks eligibility requirements for contributing to a qualified grant and lacks a specific dollar amount for limiting administration overhead costs. Lack of specificity could lead to disputes between taxpayers and the FTB and would complicate the administration of this credit.

The bill language suggests that the FTB certifies a contribution before a taxpayer applies to the FTB for a credit. If this is contrary to the author's intent, the bill should be amended.

This bill would require an organization to apply for qualified grants with the FTB but lacks administrative details on the application and grant approval process. Additionally, the State Department of Education would be required to provide a list of EIOs annually to the FTB. It is unclear why the application and certification process would be split between the two agencies. Typically, credits involving areas for which the department lacks expertise are certified by another agency or agencies that possess the relevant expertise. Certification language would specify the responsibilities of both the certifying agency and the taxpayer.

Because the bill fails to specify otherwise, an organization that fails to meet the EIO requirements could create a subordinate EIO specifically for the purpose of participating in this credit. If this is contrary to the author’s intent, this bill should be amended.

This bill lacks administrative details necessary to implement the bill and determine its impact to the department’s systems, forms, and processes. The bill is silent on the following issues:

- How would the FTB obtain the information on a calendar year basis?
- Should this credit be allocated and certified (similar to the California Film and Television Tax Credit)?

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<sup>1</sup> Chapter 3.5 (commencing with Section 11340) of Part 1 of Division 3 of Title 2 of the Government Code.

## TECHNICAL CONSIDERATIONS

The requirements for an EIO appear to be a combination of two different requirements. Some requirements pertain to an EIO and others pertain to an education innovative program. The author may wish to amend the bill to clarify the EIO requirements.

On page 4, line 5 the word “all” should be replaced with “both” because there are only two requirements that a nonprofit must meet.

On page 6, line 38, clause (iii) should be corrected to (ii).

## **LEGISLATIVE HISTORY**

AB 2421 (Nestande, 2013/2014), a similar bill, would create a tax credit for monetary contributions to a nonprofit organization that gives scholarships for foster or homeless youth to attend public or private schools. AB 2421 has been referred to the Assembly Revenue and Taxation Committee.

AB 943 (Nestande, 2013/2014), a similar bill, would have created credits for monetary contributions to a nonprofit organization that either provides grants to schools to support qualified K-12 innovative programs or that gives scholarships for foster youth or disabled children to attend public or private schools. AB 943 failed to pass out of the Assembly Revenue and Taxation Committee.

AB 2582 (Nestande, 2011/2012), a similar bill, would have created two credits for contributions to a public school for support of cocurricular activities or to an educational improvement organization that supports innovative programs in public schools. AB 2582 failed to pass out of the Assembly Revenue and Taxation Committee.

AB 1542 (Negrete-McLeod, 2011/2012), would have created an income tax credit for contributions made to a local educational advancement program (LEAP) organization. AB 1542 failed to pass out of 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 to pass 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

The FTB does not currently administer a certification and allocation process for a tax credit program under the CTL. Establishing this 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

### Revenue Estimate

Estimated Revenue Impact of AB 2422 As Amended April 1, 2014 Assumed Enactment After June 30, 2014 (\$ in Millions)		
2014-15	2015-16	2016-17
- \$3.6	- \$15	- \$22

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: Some could argue that these credits would provide funding to support enhanced educational opportunities for grades kindergarten through high school.

Opponents: Opponents may argue that these credits could constitute an indirect subsidy of public funds to religious schools.

## LEGISLATIVE STAFF CONTACT

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