ANALYSIS OF AMENDED BILL

Franchise Tax Board

Author:	Nestande, et al.	Analyst:	Jane Raboy	Bill Number:	AB 2426
Related Bills:	See Legislative History	Telephone:	845-5718	Amended Date:	May 5, 2014
		Attorney:	Bruce Langston	Sponsor:	

SUBJECT: Coverdell Education Savings Account Deduction

SUMMARY

This bill would allow a deduction for contributions to a Coverdell education savings account (Coverdell Account) under the Personal Income Tax Law.

RECOMMENDATION

No position.

Summary of Amendments

The May 5, 2014, amendments added several co-authors, made several substantive and technical changes, and clarified that the contribution to a Coverdell Account would be reported as a deduction from gross income rather than an exclusion from income.

The May 5, 2014, amendments resolved the department's implementation and technical considerations by accepting the amendments suggested in the department's analysis of the bill as amended on April 1, 2014. As a result of the amendments, this analysis replaces the department's analysis of the bill as amended April 1, 2014.

REASON FOR THE BILL

The reason for this bill is to encourage families to invest and plan for qualified educational expenses.

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, 2014.

ANALYSIS

FEDERAL/STATE LAW

Under Section 530 of the Internal Revenue Code (IRC Section 530), a Coverdell Account is a trust or custodial account created exclusively for the purpose of paying qualified education expenses of a named beneficiary. For 2013, the maximum annual contributions to a Coverdell Account may not exceed $2,000 per designated beneficiary and may not be made after the designated beneficiary reaches age 18 (except in the case of a special needs beneficiary).

Board Position:			Executive Officer	Date
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The contribution limit is phased out for taxpayers with modified adjusted gross income (MAGI) between $95,000 and $110,000 ($190,000 and $220,000 for married taxpayers filing a joint return); the MAGI[1] of the contributor, and not that of the beneficiary, controls whether a contribution is permitted by the taxpayer.

Contributions to a Coverdell Account are not tax-deductible, but the earnings grow tax-free, and so do withdrawals, as long as the distributions are used for qualified education expenses. Earnings on contributions to a Coverdell Account generally are subject to tax when withdrawn. However, distributions from a Coverdell Account are excludable from the gross income of the distributee (i.e., the student) to the extent that the distribution does not exceed the qualified education expenses incurred by the beneficiary during the year the distribution is made. The earnings portion of a Coverdell Account distribution not used to pay qualified education expenses is includible in the gross income of the distributee and generally is subject to an additional 10-percent tax.

As defined under IRC Section 530, qualified education expenses include “qualified higher education expenses” and “qualified elementary and secondary education expenses.” The term “qualified higher education expenses” includes tuition, fees, books, supplies, and equipment required for the enrollment or attendance of the designated beneficiary at an eligible education institution, regardless of whether the beneficiary is enrolled at an eligible educational institution on a full-time, half-time, or less than half-time basis. The funds for "qualified elementary and secondary education expenses" can be used to cover the costs of attending elementary and secondary school, kindergarten through grade 12. In addition to tuition, these costs can include uniforms, tutoring, computers, software, and transportation.

California law does not allow a deduction for qualified higher education expenses.

California conforms to IRC Section 530 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 education expenses. California modifies the additional 10-percent tax on excess distributions to instead be an additional tax of 2.5 percent for state purposes.

THIS BILL

This bill would allow a deduction from gross income, not to exceed $750 per taxable year, for an amount contributed to a Coverdell Account, except as otherwise provided.

This bill would define "Coverdell education savings account" to have the same meaning as defined by IRC Section 530, as modified by Section 23712.

In applying IRC Section 530, this bill would require that the basis of the Coverdell Account be reduced by any amount deducted.

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[1] MAGI includes all gross income reduced by “above-the-line” deductions (e.g. certain trade or business deductions, contributions to a medical savings account, alimony paid, and contributions to pension and annuity plans) increased by any amount excluded from gross income related to the income of citizens or residents of the United States living abroad, income from sources within Guan, American Samoa, Northern Marina Islands, or Puerto Rico.

IMPLEMENTATION CONSIDERATIONS

Implementing this bill would require some changes to existing tax forms and instructions and information systems, which could be accomplished during the normal annual update.

LEGISLATIVE HISTORY

AB 757 (Niello, 2009/2010) would have allowed an amount deposited by a taxpayer during the taxable year in an education savings account to be excluded from the gross income of the beneficiary of the account. AB 757 failed passage in the Assembly Revenue and Taxation Committee.

AB 3 (Blakeslee, 2005/2006) would have allowed a deduction for contributions made by a taxpayer to a qualified tuition program. AB 3 failed passage in the Assembly Revenue and Taxation Committee.

OTHER STATES' INFORMATION

Florida, Illinois, Massachusetts, Michigan, Minnesota, and *New York* laws do not provide a deduction from gross income comparable to this bill. The laws of these states were selected due to their similarities to California's economy, business entity types, and tax laws.

FISCAL IMPACT

This bill would not significantly impact the department's costs.

ECONOMIC IMPACT

Revenue Estimate

Estimated Revenue Impact of AB 2426 As Amended May 5, 2014 Assumed Enactment After June 30, 2014		
2014-15	2015-16	2016-17
- $900,000	- $600,000	- $700,000

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

SUPPORT/OPPOSITION[2]

Support: Catholic Conference and Palm Desert Area Chamber of Commerce.

Opposition: None provided.

[2] As provided by the Assembly Member Brian Nestande's Assembly Bill 2426, Fact Sheet as of April 3, 2014.

ARGUMENTS

Proponents: Supporters may argue that a contribution deduction may encourage additional savings in Coverdell Accounts.

Opponents: Some may argue that a contribution deduction may have a minimal impact and would fail to encourage additional savings in Coverdell Accounts.

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