Franchise Tax Board | **ANALYSIS OF AMENDED BILL**

Author:	Nestande	Analyst:	Jane Raboy	Bill Number:	AB 943
Related Bills:	See Prior Analysis	Telephone:	845-5718	Amended Date:	January 6, 2014
		Attorney:	Bruce Langston	Sponsor:	

SUBJECT: Education Investment Incentives Tax Credits

SUMMARY

This bill would create the Nonprofit Education Improvement Organization and the Nonprofit Education Scholarship Organization tax credits under the Corporation Tax Law (CTL).

RECOMMENDATION

No position.

SUMMARY OF AMENDMENTS

The January 6, 2014, amendments removed the provisions of the bill that would have established two credits under Personal Income Tax Law and Corporation Tax Law relating to monetary contributions to nonprofit organizations to fund scholarships and cocurricular activities, and replaced them with the provisions discussed in this analysis. This analysis replaces the department's previous analysis of the bill as introduced on February 22, 2013.

REASON FOR THE BILL

The reason for this bill is to encourage contributions to support innovative private, public and charter school programs and to support scholarships for children with special needs or in foster care to attend a private school 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.

Board Position:			Legislative Director	Date
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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.

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.

THIS BILL

For taxable years beginning on or after January 1, 2015, and before January 1, 2020, this bill would establish, under the CTL, the Nonprofit Education Improvement Organization (Grant) credit and the Nonprofit Education Scholarship Organization (Scholarship) credit, with a sunset date of December 1, 2020.

1. *Grant Credit*

This bill would create a tax credit equal to 50 percent of a monetary contribution made by a taxpayer to a nonprofit education improvement organization, as defined, to fund a qualified grant for a K-12 education innovation program for pupils attending private, public or charter schools, as defined.

The following requirements would apply to the Grant credit:

- The tax credit is limited to 50 percent of the taxpayer's "tax" for the taxable year.
- A taxpayer is required to apply for and receive certification from the Franchise Tax Board (FTB).
- Any unused tax credit is allowed to be carried forward up to six years, until the credit is exhausted.
- The tax credit is in lieu of any other credit or deduction claimed by a taxpayer for contributions made to a nonprofit education improvement organization.
- The tax credit must be claimed on a timely filed original return.

The aggregate amount allowed would be limited to a maximum of $50 million for each calendar year, inclusive of both the Grant and Scholarship tax credits, and the allocation of the credits would be on a first-come, first-serve basis. The Legislature is 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 the rules and regulations as necessary or appropriate in implementing the Grant credit.
- Establish application forms and procedures.
- Track credits claimed.
- Post aggregate totals of the credits claimed on the Internet Web site of the FTB.
- Determine when the aggregate total of credits reaches $50 million.
- Certify that the contributions meet the requirements for the tax credit.

The rules, guidelines, and procedures established would be exempt from the regulatory requirements of the Administrative Procedures Act.[1]

The State Department of Education is required to perform the following:

- Adopt rules necessary to determine whether the Grant Institution, private school, and contribution requirements are met; and
- Submit a list of eligible Grant Institutions 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."

2. *Scholarship Credit*

This bill would create a Scholarship tax credit equal to 50 percent of the monetary contribution made by a taxpayer to a nonprofit education scholarship organization, as defined, to fund qualified K-12 education scholarships for a specified pupil to attend private school or to fund partial or full payments of fees associated with the general costs of transportation to attend a private, public, or charter school.

The following requirements would apply to the Scholarship credit:

- The tax credit is limited to 50 percent of the taxpayer's "tax" for the taxable year.
- The taxpayer is required to apply for and receive certification from the FTB.
- Any unused tax credit is allowed to be carried forward up to six years, until the credit is exhausted.
- The tax credit is in lieu of any other credit or deduction claimed by a taxpayer for contributions made to a nonprofit education scholarship organization.
- The tax credit would be required to be filed on a timely file an original return.

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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.

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- Promulgate rules and regulations as necessary or appropriate in implementing the credit.
- Establish application forms and procedures.
- Track credits claimed.
- Post aggregate totals of the credits claimed on the Internet Web site of the FTB.
- Determine when the aggregate total of credits reaches $50 million.
- Certify that the contributions meet the requirements for the tax credit.

The rules, guidelines, and procedures established would be exempt from the regulatory requirements of the Administrative Procedures Act.[2]

The State Department of Education is required to perform the following:

- Adopt rules necessary to determine whether the Scholarship Institution, private school, and contribution requirements are met; and
- Submit a list of eligible education improvement organizations annually to the FTB, by March 15.

The bill provides definitions for various terms including “education scholarship organization,” “nonprofit,” “qualified K-12 education scholarship,” specified pupil,” and “private school.

<u>IMPLEMENTATION CONSIDERATIONS</u>

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 for the eligibility requirements and administration for both tax credits. For example, the Grant 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.

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

Although the FTB would be required to provide a qualified grant to the Grant Institution, it is unclear if the Grant Institution qualifies for the contribution or when the FTB would be required to take action on this request once the request has been received. If the FTB is required to complete the request within 45 days, it would be extremely difficult to complete given that this would be a new workload, outside the current expertise of the FTB, requiring the redirection of current resources, and possibly the hiring of new personnel. To avoid disputes between the department and taxpayers this bill should be amended to remove the requirement that the FTB "certify" that expenses meet the requirements of the statute.

Typically, credits involving areas for which the department lacks expertise are certified by another agency or agencies that possess the relevant expertise. The certification language would specify the responsibilities of both the certifying agency and the taxpayer. For example, the Scholarship credit requires the Scholarship Institution to submit financial and compliance audit reports performed by a certified public accountant to the FTB but it is unclear how the FTB will make a determination that the contribution meets the requirements by reviewing the compliance audit reports to provide a certification to a taxpayer.

As defined for the “scholarship credit,” a private school means a person offering or conducting private school instruction on the elementary or high school level. This definition could allow a family with a school aged child (or children) with special needs, or a foster care family with school aged children, that are being home schooled, to set up a 501(c)(3) nonprofit organization, make contributions to the nonprofit for those children to receive scholarship at the home school and get a credit and a deduction for the amounts contributed. If this is not the intent of the author, amendments would be necessary.

<u>TECHNICAL CONSIDERATIONS</u>

On page 6, line 21, the acronym “ESOs” should read “EIOs” to correct an error.

LEGISLATIVE HISTORY

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 Grant or Scholarship tax credit under the CTL. Establishing a Grant or Scholarship 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 943 As Amended January 6, 2014 Enactment Assumed After June 30, 2014 ($ in Millions)		
2014-15	2015-16	2016-17
n/a	-$24	-$34

This estimate 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 12, as well as provide new opportunities for special needs and foster care children.

Opponents: Some could argue that with the state's current fiscal crisis, additional tax expenditures should be avoided.

LEGAL CONCERNS

Historically, tax credits have been designed to provide incentives for taxpayers to perform various actions or activities within the state that they may not otherwise undertake. But if the bill were to be amended to restrict this credit to public schools and private schools located in California, this could raise constitutional concerns under the Commerce Clause of the United States Constitution because it could appear to favor in-state businesses. On August 28, 2012, (*Cutler v. Franchise Tax Board*), the Court of Appeal issued a unanimous opinion holding that California's Qualified Small Business Statute is unconstitutional. Specifically, the Court of Appeal held that the California-heavy requirements of this investment incentive statute facially discriminates against interstate commerce, and therefore violates the federal dormant commerce clause. While no court decision has yet invalidated, as a general matter, state income tax credits that provide an incentive for in-state activity, i.e., property placed in service in the state, employees employed in the state, etc., targeted tax credits that are conditioned on location in California may be subject to constitutional challenge.

POLICY CONCERNS

Some special needs children remain in school beyond the standard graduation age. Some of those children remain in special programs. As written, the contributions made to those special programs would continue to be eligible for the credit indefinitely for any child that does not graduate from high school. If this is contrary to the author's intent, the author may wish to amend the language to put in another cut off mechanism, such as reaching a specific age.

LEGISLATIVE STAFF CONTACT

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