Franchise Tax Board

ANALYSIS OF ORIGINAL BILL

Author:	Nestande	Analyst:	David Scott	Bill Number:	AB 943
Related Bills:	See Legislative History	Telephone:	845-5806	Introduced Date:	February 22, 2013
		Attorney:	Patrick Kusiak	Sponsor:	

SUBJECT: Contributions to Nonprofit Organization to Fund Private School Scholarships or Grants for Science, Technology, Engineering, & Math Literacy, & The Arts for Public & Charter Schools Credit

SUMMARY

This bill would establish the following income and franchise tax credits:

- A credit under the Personal Income Tax Law (PITL) and Corporation Tax Law (CTL) for monetary contributions to nonprofit organizations to fund scholarships for special needs and foster care pupils to attend private schools.
- A credit under the PITL and CTL for monetary contributions to nonprofit organizations to fund cocurricular activities in science, technology, engineering, math literacy, and the arts at public and charter schools.

RECOMMENDATION

No position.

REASON FOR THE BILL

The reason for this bill is to encourage contributions to support innovative 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, 2013, and before January 1, 2017.

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.

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Existing federal and state laws allow individuals to deduct certain expenses, such as medical expenses, charitable contributions, interest, and taxes, as itemized deductions. Certain other expenses for the production of income and certain employee business expenses are considered miscellaneous itemized deductions and on the portion that exceeds 2 percent of adjusted gross income may be deducted. Also, itemized deductions may be further limited for high-income taxpayers.

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

The bill would, for taxable years beginning on or after January 1, 2013, and before January 1, 2017, establish two credits, the Scholarship Credit and the Cocurricular Activity Grant Credit, under both the PITL and the CTL.

Scholarship Credit

This credit would be a dollar for dollar credit, subject to a maximum of 50 percent of a taxpayer's tax[1] for the taxable year, for contributions to a nonprofit organization to fund qualified scholarships for pupils with special needs or in foster care to attend private schools.

For this credit, this bill would define the following terms:

- "Nonprofit organization" means an organization that is tax-exempt under Section 501(c)(3) of the Internal Revenue Code.
- "Private school" means a person, firm, association, partnership, or corporation offering or conducting private school instruction on the elementary or high school level.
- "Qualified Scholarship" means a scholarship for a pupil with special needs or a pupil in foster care to attend a private school that meets all of the following:
  - The pupil remains eligible for the scholarship until he or she graduates from high school or leaves the foster care program.
  - The scholarship may be used at any private school if the pupil's residence changes and attendance at a particular private school is not feasible.
  - Eligibility for the scholarship shall be based on family income, not to exceed 250 percent of the federal poverty guidelines. A partial scholarship may be granted if the family income of a pupil that was awarded a scholarship in the previous year increases in the following year.

The nonprofit organization would be required to maintain data on the educational progress of scholarship recipients.

The maximum amount of the credits for all taxable years for all taxpayers would be $50 million.

A taxpayer's unused allowed credits may be carried over to subsequent years until exhausted.

[1] "net tax" under PITL and "tax" under CTL.

Unless other limitations apply, taxpayers would be allowed a charitable deduction in addition to this credit.

The Franchise Tax Board (FTB) would be authorized to promulgate rules and regulations as necessary or appropriate to implement this credit. Those rules and regulation would be excluded from the rulemaking provisions of the Administrative Procedures Act.

Cocurricular Activity Grant Credit

This credit would be a dollar for dollar credit, subject to a maximum of 50 percent of a taxpayer's tax[2] for the taxable year, for contributions to nonprofit organizations to provide grants to public and charter schools for qualified programs.

For this credit, this bill would define the following terms:

- "Charter school" means a school established pursuant to Part 26.8 (commencing with Section 47600) of Title 2 of the Education Code providing elementary or high school education.
- "Nonprofit organization" means an organization that is tax-exempt under Section 501(c)(3) of the Internal Revenue Code.
- "Public school" means any day or evening elementary school or any day or evening high school established by statute, or by municipal or district authority.
- "Qualified program" means a program in science, technology, engineering, and math literacy, and the arts of public and charter schools that is both of the following:
    - An advanced academic or similar program that is not part of the regular program of a public or charter school.
    - A cocurricular activity for pupils that is an optional, noncredit educational activity that supplements education, including, but not limited to, gifted programs, visual and performing arts, music arts, academic clubs, and educational field trips.

The grant may be for one or more schools and include guidelines for what the funding can be used for. The funding may not be used for administrative or overhead costs.

The maximum amount of the credits for all taxable years for all taxpayers would be $50 million.

The unused credits allowed in any taxable year may be carried forward until exhausted.

Unless other limitations apply, taxpayers would be allowed a charitable deduction in addition to this credit.

The FTB would be authorized to promulgate rules and regulations as necessary or appropriate to implement this credit. Those rules and regulation would be excluded from the rulemaking provisions of the Administrative Procedures Act.

[2] "net tax" under PITL and "tax" under CTL.

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. In order for the FTB to implement this bill, clarification is necessary for the following issues.

This bill lacks administrative details that must be determined to implement the bill and determine its impacts to the department's systems, forms, and processes. For example, the bill is silent on the following issues:

- How would credits reported on a return other than a timely-filed, original return affect the calculation of the aggregate total? Would credits disallowed, for example, as a result of an audit, trigger a recalculation of the aggregate total?
- How would the aggregate total amount of contributions be tracked and by whom? Would the information be made available to the public? How, by whom, and when?
- How would claimed credits in excess of the aggregate total be treated?
- Who would evaluate the effectiveness of the qualified scholarship programs? What would happen if the intended results are not met? Would the data retained by the nonprofit organization be available to other organizations or individuals?
- Who determines that the student meets the requirements to receive a scholarship?

It is recommended that the bill be amended to clarify these conditions and rules to eliminate confusion as to the author's intentions.

This bill does not provide definitions of a program in science, technology, engineering, and math literacy, or the arts. However the Education Code provides for what is allowable curriculum and programs for elementary and secondary schools. The author may wish to reference the Education Code when referring to these programs under the definition of "qualified program."

A certified credit that is specifically allocated by another agency could eliminate any uncertainty as to the availability of the credit. For example, because the credits would be allowed based on the filing of a return claiming the credit rather than the date a contribution is made, a taxpayer that made the earliest contribution during a taxable year could be denied the credit if the aggregate total credit amount had been reached at the time the taxpayer filed that year's return. Uncertain tax consequences could lead to disputes between taxpayers and the department. If this is contrary to the author's intent, the author may wish to consider a credit that is certified at the time a contribution is made.

As defined, private and public schools for purposes of the credits would include schools that are located both within and outside of California. If this is contrary to the author's intent, this bill should be amended.

As defined for the "scholarship credit," a private school means <u>a person</u> 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.

TECHNICAL CONSIDERATIONS

The language that would allow the credit in addition to any allowable deduction is unnecessary since existing state law already provides this result. The following corrections should be made:

- on page 3, delete lines 38 and 39,
- on page 4, delete lines 12 and 13,
- on page 5, delete lines 22 and 23, and
- on page 6, delete lines 36 and 37.

The subdivisions in each section, after the above deletions, would have to be renumbered.

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

Because this bill is silent on a number of administrative questions, the department is unable to determine the costs to administer this bill until implementation concerns have been resolved. As the bill continues to move through the legislative process and implementation concerns are resolved, costs will be identified and an appropriation will be requested, if necessary.

ECONOMIC IMPACT

Revenue Estimate

Estimated Revenue Impact of AB 943 As Introduced On February 22, 2013 For Taxable Years Beginning On or After January 1, 2013 Assumed Enactment After June 30, 2013 ($ in Millions)		
2013-14	2014-15	2015-16
- $70	- $25	- $13

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 opportunites 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.

POLICY CONCERNS

Generally, credits are limited as a percentage of amounts paid or incurred. This bill would allow a 100 percent credit, which is unprecedented.

This bill would allow taxpayers in certain circumstances to claim multiple tax benefits for the same item of expense.

This bill would allow for an unlimited carryover period. Consequently, the department would be required to retain the carryover on the tax forms indefinitely. Recent credits have been enacted with a carryover period limitation because experience shows credits typically are exhausted within eight years of being earned.

This bill defines "private school", "public school", and "charter school." The "charter school" definition refers to the Education Code, however neither the definition of "public school" or "private school" refers to the Education Code or has any geographic requirement. As a result, taxpayers could argue that this bill would allow the credit for "public schools" or "private schools" located anywhere.

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.

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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