Franchise Tax Board

ANALYSIS OF AMENDED BILL

Author:	Correa	Analyst:	Michelle Chan	Bill Number:	SB 693
Related Bills:	See Legislative History	Telephone:	845-6805	Amended Date:	April 11, 2013
		Attorney:	Patrick Kusiak	Sponsor:	

SUBJECT: Parent or Guardian Education-Related Expenses Credit/Teacher, Instructor, Counselor, Principal, or Aide Unreimbursed Classroom Supplies & Instructional Materials Expenses Credit

SUMMARY

This bill would create two income tax credits under the Personal Income Tax Law for certain education-related expenses.

RECOMMENDATION

No position.

Summary of Amendments

As introduced on February 22, 2013, this was a spot bill. The April 11, 2013, amendments added the provisions discussed in this analysis. This is the department's first analysis of the bill.

REASON FOR THE BILL

The reason for this bill is to ease the financial burden of providing a high-quality K-12 education on low and middle income parents and education professionals beginning their careers.

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, 2014, and before January 1, 2019.

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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Current federal law allows eligible educators to deduct up to $250 of the cost to purchase books, supplies (other than nonathletic supplies for courses of instruction in health or physical education), computer equipment (including related software and services) and other equipment, and supplementary materials used by the eligible educator in the classroom as an adjustment to gross income. This 'above-the-line' deduction applies to taxable years beginning on or after January 1, 2002, and before January 1, 2014. California does not conform to this deduction.

There are currently no federal or state credits comparable to the credit for parents or guardians for education related expenses that this bill would create.

THIS BILL

This bill would create two personal income tax credits as discussed below:

1. Parent or Guardian Education-Related Expenses Credit (Parent or Guardian Credit)

This bill would, for taxable years beginning on or after January 1, 2014, and before January 1, 2019, create a tax credit for the qualified amount that shall not exceed $500 per household that was paid or incurred for qualified education-related expenses for one or more dependent children by a low-income or middle-income parent or guardian during the taxable year.

For the purpose of determining this credit, the following definitions would apply:

- "Dependent children" means children who attend kindergarten or any grades 1 to 12, inclusive, in California at a public, charter, or private school that has a current private school affidavit on file with the State Department of Education in the taxable year and who meet the requirements of Section 152(c)(1)(B), (D), and (E) of the Internal Revenue Code (IRC)[1].

- "Qualified amount" means the following:

    - If the qualified education-related expenses are $250 or less, the amount paid or incurred for those expenses.
    - If the qualified education-related expenses are more than $250 and less than $1,250, $250 plus 25 percent of the difference between the amounts paid or incurred for those expenses and $250.
    - If the qualified education-related expenses are more than $1,250, $500.

- "Qualified education-related expenses" means the costs of textbooks, school supplies, including, but not limited to, pens, paper, pencils, notebooks, calculators, and rulers, school uniforms, computers, computer hardware, and educational computer software used to learn academic subjects, tuition, tutoring, psychoeducational diagnostic evaluations to assess the cognitive and academic abilities of pupils, special education services for pupils who have an individualized education program or its equivalent, academic after-school programs, out-of-school enrichment programs, public transportation, third-party transportation, and the rental or purchase of educational equipment required for classes held during the regular school year.

[1] The term qualifying child under this section means, an individual, who has the same principal place of residence as the taxpayer for more than one-half of that tax year, who hasn't provided over one-half of his or her own support for the calendar year, and who must be younger than the claimant and be unmarried; qualifying child benefits restricted to child's parents.

Expenses for items that are used in a trade or business would be specifically excluded from the definition of "qualified education-related expenses."

- "Low-income or middle-income parent or guardian" means a parent or legal guardian of a full-time pupil who is under 21 years of age at the close of the school year who meets both of the following requirements:
  - Both the pupil and the parent or guardian resides in California when the qualified education-related expenses were paid or incurred.
  - The household income does not exceed 300 percent of the federal Income Eligibility Guidelines published by the Food and Nutrition Service of the United States Department of Agriculture for use in determining eligibility for reduced price meals.

  If more than one parent or guardian qualifies for the credit, the following rules would apply to determine which parent is entitled to the credit:

  - The credit would be allowed to the parent or guardian having custody for the greater portion of the calendar year.
  - If the child resides with more than one parent or guardian for the same amount of time during the taxable year, the parent or guardian with the highest adjusted gross income would be allowed the credit.

- "Tuition" means tuition for a private school with kindergarten or any grades 1 to 12, inclusive, or for college courses or summer school courses that satisfy high school graduation requirements.

Any unused credit may be carried over to reduce tax for the following five years, if necessary, until the credit is exhausted.

The Franchise Tax Board (FTB) would have the authority to prescribe rules, guidelines or procedures necessary or appropriate to carry out the purpose of the credit while exempting these rules, guidelines, or procedures from the normal rulemaking requirements of the Administrative Procedures Act.

This tax credit would be repealed by its own terms as of December 1, 2019, unless a later enacted statute, that is enacted before January 1, 2019, deletes or extends that date.

2. <u>Teacher, Instructor, Counselor, Principal or Aide Unreimbursed Classroom Supplies and Instructional Materials Expenses Credit (Education Professional Credit)</u>

This bill would, for taxable years beginning on or after January 1, 2014, and before January 1, 2019, create a tax credit in an amount equal to the amount paid or incurred by a qualified taxpayer during the taxable year for instructional materials and classroom supplies, not to exceed $250.

For the purpose of determining this credit, the following definitions would apply:

- "Instructional materials and classroom supplies" means any unreimbursed expenses, otherwise deductible as a trade or business expense, for books, supplies, computer equipment, including related software and services and other equipment, and supplementary materials used in the classroom.
- "Qualified taxpayer" means a person who works at least 900 hours in the school year as a teacher, instructor, counselor, principal, or aide in a school for kindergarten or any grades 1 to 12, inclusive.

The credit would be available for the first three years of employment as a teacher, instructor, counselor, principal, or aide in a school for kindergarten or any grades 1 to 12, inclusive.

Any unused credit may be carried over to reduce tax for the following five years if necessary, until the credit is exhausted.

The FTB would be authorized to prescribe rules, guidelines or procedures necessary or appropriate to carry out the purpose of the credit while exempting these rules, guidelines, or procedures from the normal rulemaking requirements of the Administrative Procedures Act.

This tax credit would be repealed by its own terms as of December 1, 2019, unless a later enacted statute, that is enacted before January 1, 2019, deletes or extends that date.

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 uses terms that are undefined, i.e., "household" and "household income." The absence of definitions to clarify these terms could lead to disputes with taxpayers and would complicate the administration of the credit allowed to parents and guardians for education-related expenses.

In order to be eligible for these credits, a taxpayer would have to meet a number of qualifications that the department lacks the data to confirm. For example, the requirement under the Parent and Guardian Credit that household income does not exceed 300 percent of the federal Income Eligibility Guidelines published by the Food and Nutrition Service of the United States Department of Agriculture and the definition of a qualified taxpayer under the Education Professional Credit means teaching at least 900 hours in the school year in an elementary or secondary school. Typically, credits or requirements 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. Additionally, the certification could be provided by the taxpayer upon the department's request.

This bill references federal law (IRC sec. 152(c)(1)(B)) in the definition of dependent children. That IRC section requires the principal place of abode of the child to be the same as the principal place of abode of the taxpayer for more than half of the taxable year. The bill also contains a rule to determine eligibility for the credit in the case where the child resides with more than one parent or guardian for the same amount of time. These two rules are in conflict. To avoid confusion amongst taxpayers, the author may consider amending the bill to delete the reference to IRC sec. 152(c)(1)(B) for consistency.

This bill provides that if a child resides with more than one parent or guardian for the same amount of time during the taxable year, the parent or guardian with the highest Adjusted Gross Income (AGI) would be allowed the tax credit. It is unlikely that the parents or guardians will be aware of the others AGI, and at the time returns are being processed, the department would be unable to determine which taxpayer has the highest AGI. As a result, the credit may inadvertently be allowed to a non-qualified taxpayer. To avoid conflicts between taxpayers and the department, the bill should be amended.

LEGISLATIVE HISTORY

SB 413 (Knight, 2013/2014) would create a personal income tax credit for qualifying science, technology, engineering, or mathematics (STEM) teachers. SB 413 is currently set for hearing on May 8, 2013 before the Senate Governance and Finance Committee.

AB 1071 (Fuentes, 2011/2012) would have created an income tax credit for the purchase of qualified school supplies by a credentialed teacher. AB 1071 failed passage out of the Assembly Revenue and Taxation Committee.

AB 2088 (Bonilla, 2011/2012) would have created a personal income tax credit for qualifying science, technology, engineering, or mathematics (STEM) teachers. AB 2088 failed passage out of the Assembly Revenue and Taxation Committee.

SB 87 (Senate Budget Committee, Chapter 180, Statutes of 2007) repealed the provision authorizing the Teacher Retention Credit that was allowed to credentialed teachers in specified amounts depending on the number of service years as a credentialed teacher in a qualifying educational institution.

SB 1438 (Railey, 1999/2000) would have established a credit of 100 percent of the costs, to a maximum of $200, for qualified educational expenses paid or incurred by a parent or teacher. SB 1438 failed to pass out of the Senate Revenue and Taxation Committee by the constitutional deadline.

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.

Illinois allows a credit in an amount equal to 25 percent of qualified education-related expenses paid or incurred by a parent or legal guardian on behalf of qualifying pupils. The maximum amount of the credit is $500.

Minnesota allows a credit in an amount equal to 75 percent of education-related expenses for a qualifying child in kindergarten through grade 12 (K-12). The maximum credit that can be claimed is based on the taxpayer's household income and the number of qualifying children the taxpayer has in grades K-12.

New York allows a full-year resident taxpayer to choose between a refundable credit or an itemized deduction for qualified college tuition expenses, and all other taxpayers (i.e., nonresidents and part-year residents) may be entitled to an itemized deduction for these expenses.

Massachusetts and *Michigan* does not offer tax credits for education-related expenses.

Florida only has a corporation income tax therefore this personal income tax credit is not applicable.

FISCAL IMPACT

Department staff is unable to determine the costs to administer this bill until the implementation concerns have been resolved. As the bill continues to move through the legislative process and the implementation concerns are resolved, costs will be identified and an appropriation will be requested, if necessary.

ECONOMIC IMPACT

Revenue Estimate

Estimated Revenue Impact of SB 693 As Amended April 11, 2013 For Taxable Years Beginning On or After January 1, 2014 Assumed Enactment After June 30, 2013 ($ in Millions)		
2013-14	2014-15	2015-16
$0	-$850	-$850

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

LEGAL IMPACT

The Parent and Guardian credit would require both the pupil and the parent or guardian to reside in California at the time the qualifying expenses were paid or incurred. In addition, this credit defines "dependent children" as children who attend kindergarten or any grades 1 to 12 in California. This could raise constitutional concerns under the Commerce Clause of the United States Constitution because it could appear to improperly favor in-state activity over out-of-state activity. On August 28, 2012, (*Cutler* v. Franchise Tax Board), the Court of Appeal issued a unanimous opinion holding that California's Qualified Small Business Stock statutes were unconstitutional. Specifically, the Court of Appeal held that the statutory scheme's requirement of a large California presence in order to qualify for an investment incentive discriminated against interstate commerce, and therefore violated 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, or employers located in the state, etc., targeted tax credits such as the ones proposed by this bill may be subject to constitutional challenge.

SUPPORT/OPPOSITION

Support: California Catholic Conference.

Opposition: None provided.

ARGUMENTS

Proponents: Supporters could argue that this bill would provide some needed financial assistance to teachers and parents who reach into their own pockets to fund vital education resources and services.

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

POLICY CONCERNS

This bill would allow a credit for specified classroom purchases that may currently be deductible as employee business expenses. Generally, a credit is allowed in lieu of a deduction in order to eliminate multiple tax benefits for the same item of expense.

The bill lacks a recapture period. A teacher could spend $1,000 on school supplies and claim a $250 credit, then in a later year return the $1,000 in supplies, and still claim the entire credit. The author may wish to add language to require that those supplies be provided to, or used by, the pupils or used by teacher in the classroom.

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