

SUMMARY ANALYSIS OF AMENDED BILL

Author:	<u>Stone</u>	Analyst:	<u>Diane Deatherage</u>	Bill Number:	<u>SB 1148</u>
Related Bills:	<u>None</u>	Telephone:	<u>845-4783</u>	Amended Date:	<u>April 25, 2016</u>
		Attorney:	<u>Bruce Langston</u>	Sponsor:	<u></u>

SUBJECT: Qualified Tuition and Related Expenses Deduction

SUMMARY

This bill would allow a deduction for qualified tuition and related expenses to be taken by a taxpayer as an above-the-line deduction when calculating adjusted gross income (AGI), under the Personal Income Tax Law.

RECOMMENDATION

No position.

SUMMARY OF AMENDMENTS

The April 25, 2016, amendments removed the provisions that would have allowed a stand-alone deduction for educational expenses, and replaced them with provisions that would conform to the federal above-the-line qualified tuition and related expenses deduction with modifications, as discussed in this analysis.

In addition, the amendments resolved all of the implementation considerations, technical considerations, and policy concerns discussed in the department's analysis of the bill as introduced on February 18, 2016, and two additional technical considerations are identified.

Except for the "Effective/Operative Date," "This Bill," "Implementation Considerations," "Technical Considerations," "Economic Impact," and "Policy Concerns" sections, the remainder of the department's analysis of the bill as introduced on February 18, 2016, still applies. The "Federal Law," "State Law," "Fiscal Impact," and "Support/Opposition" sections have been restated below for convenience.

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, 2016, and before January 1, 2021.

FEDERAL LAW

Existing federal law allows for the deduction of certain expenses when calculating AGI, such as moving expenses, qualified tuition and related expenses, and interest on education loans. Thus, all taxpayers with this type of expense receive the benefit of the deduction. These are known as above-the-line deductions.

Through tax year 2016, an individual is allowed a deduction for qualified tuition and related expenses for higher education paid by the individual during the taxable year. The deduction is allowed in computing AGI. The term "qualified tuition and related expenses" is defined in the same manner as for the Hope and Lifetime Learning credits, and includes tuition and fees required for the enrollment or attendance of the taxpayer, the taxpayer's spouse, or any dependent of the taxpayer with respect to whom the taxpayer may claim a personal exemption, at an eligible institution of higher education for courses of instruction of such individual at such institution. The expenses must be in connection with enrollment at an institution of higher education during the taxable year, or with an academic period beginning during the taxable year or during the first three months of the next taxable year. The deduction is not available for tuition and related expenses paid for elementary or secondary education.

The maximum deduction is \$4,000 for an individual whose AGI for the taxable year does not exceed \$65,000 (\$130,000 in the case of a joint return), or \$2,000 for other individuals whose AGI does not exceed \$80,000 (\$160,000 in the case of a joint return). No deduction is allowed for an individual whose AGI exceeds the relevant AGI limitations, for a married individual who does not file a joint return, or for an individual with respect to whom a personal exemption deduction may be claimed by another taxpayer for the taxable year.

The amount of qualified tuition and related expenses must be reduced by certain scholarships, educational assistance allowances, and other amounts paid for the benefit of such individual, and by the amount of such expenses taken into account for purposes of determining any exclusion from gross income of: (1) income from certain U.S. savings bonds used to pay higher education tuition and fees; and (2) income from a Coverdell education savings account.

Additionally, such expenses must be reduced by the earnings portion (but not the return of principal) of distributions from a qualified tuition program if an exclusion from income under Internal Revenue Code (IRC) section 529 is claimed with respect to expenses eligible for the qualified tuition deduction. No deduction is allowed for any expense for which a deduction is otherwise allowed or with respect to an individual for whom a Hope or Lifetime Learning credit is elected for such taxable year.

The deduction is not allowed to an individual if that individual is claimed as a dependent on another taxpayer's return for the taxable year. A qualified education loan generally is defined as any indebtedness incurred to pay for the qualified higher education expenses of the taxpayer, the taxpayer's spouse, or any dependent of the taxpayer as of the time the indebtedness was incurred in attending (1) post-secondary educational institutions and certain vocational schools defined by reference to section 481 of the Higher Education Act of 1965, or (2) institutions conducting internship or residency programs leading to a degree or certificate from an institution of higher education, a hospital, or a health care facility conducting postgraduate training.

Qualified higher education expenses are defined as the student's cost of attendance (generally, tuition, fees, room and board, and related expenses), reduced by (1) any amount excluded from gross income for redemption of U.S. savings bonds, (2) any amount distributed from an education Individual Retirement Account and excluded from gross income, and (3) the amount of any scholarship or fellowship grants excludable from gross income, as well as any other tax-free educational benefits, such as employer-provided educational assistance, that is excludable from the employee's gross income.

STATE LAW

California specifically does not conform to the federal qualified tuition deduction. As a result, California does not allow a deduction for qualified tuition and related expenses, and taxpayers who deduct such expenses on their federal tax returns report the amount deducted for federal purposes as a California adjustment on Schedule CA (540/540NR).

THIS BILL

For taxable years beginning on or after January 1, 2016, and before January 1, 2021, this bill would conform, with modifications, to the federal deduction allowed, when determining AGI, for the amount paid or incurred by a taxpayer during the taxable year for qualified tuition and related expenses.

The bill would modify the maximum amount allowed as a deduction under federal law; for California purposes, the maximum amount allowed as a deduction would be as follows:

- In the case of a taxpayer whose AGI for the taxable year does not exceed \$125,000, or \$250,000 in the case of a joint return, \$10,000 per individual;
- In the case of any other taxpayer, no deduction would be allowed.

Under this bill, for each taxable year beginning on or after January 1, 2017, the Franchise Tax Board (FTB) would adjust the AGI and deduction amounts for inflation using the California Consumer Price Index.¹

The bill would specifically not conform to the federal expiration date of the deduction.²

This deduction would be repealed by its own terms as of December 1, 2021.

¹ As specified in Revenue and Taxation Code (R&TC) section 17041(h).

² The federal qualified tuition and related expenses deduction expires after 2016; its termination date, under IRC section 222(e), was extended for two years, through 2016, under the Protecting Americans from Tax Hikes Act of 2015.

IMPLEMENTATION CONSIDERATIONS

Implementing this bill would require some changes to existing tax forms and instructions and information systems.

TECHNICAL CONSIDERATIONS

The language should be clarified by deleting “per individual” on page 2, line 18.

The bill would provide that both the AGI and deduction amounts would be annually adjusted for inflation.³ If this is contrary to the author’s intent, the language should be amended to annually adjust only the AGI amount.

FISCAL IMPACT

The department’s costs to implement this bill have yet to be determined. As the bill moves through the legislative process, costs will be identified and an appropriation will be requested, if necessary.

ECONOMIC IMPACT

Revenue Estimate

This bill would result in the following revenue loss:

Estimated Revenue Impact of SB 1148 As Amended on April 25, 2016 Assumed Enactment After June 30, 2016 (\$ in Millions)		
2016-17	2017-18	2018-19
- \$41	- \$27	- \$28

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

Revenue Discussion

Based on FTB data, it was determined that approximately 125,000 Californians claimed \$225 million in deductions for higher education expenses on their federal tax return in 2013. Data shows that 60 percent, or 75,000 taxpayers, claimed less than the maximum deduction allowed for a total of \$85 million. It is assumed these taxpayers would claim the same amount of deductions on their California return. The remaining 40 percent, or 50,000 taxpayers, reported the maximum amount allowed of either \$4,000 or \$2,000, as limited by their modified AGI. The

³ R&TC section 17041(h) provides for annual adjustments of the income tax brackets based on inflation information.

dollar limit specified in this bill is increased to \$10,000 in expenses per individual. It assumed that these taxpayers would deduct \$8,500 on average, adding \$425 million for a total estimated deduction of \$500 million. This amount is then increased by 20 percent to account for those taxpayers who can now claim the deduction due to the increase in the modified AGI.

This results in an estimated \$700 million of deductions in the first year available. Applying an estimated average tax rate of 4 percent and a 1 percent increase for non-residents results in an estimated revenue loss of \$26 million in taxable year 2016.

The tax-year estimates are converted to fiscal-year estimates, and then rounded to arrive at the amounts reflected in the above table.

SUPPORT/OPPOSITION

Support: None provided.

Opposition: None provided.

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