

ANALYSIS OF ORIGINAL BILL

Author: Pavley Analyst: Scott McFarlane Bill Number: SB 324
 Related Bills: See Legislative History Telephone: 845-6075 Introduced Date: February 23, 2015
 Attorney: Bruce Langston Sponsor _____

SUBJECT:	The California Achieving a Better Life Experience (ABLE) Act
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SUMMARY

This bill would establish a California ABLE program and would modify California income tax law to generally conform to the federal income tax treatment of ABLE accounts.

This analysis only addresses the provisions of the bill that would impact the department's programs and operations, and not the provisions that would be administered by the California State Treasurer's Office.

RECOMMENDATION

No position.

Summary of Suggested Amendments

Minor technical amendments are suggested.

REASON FOR THE BILL

The reason for the bill is to ensure that individuals with developmental disabilities and their families will be able to save money without fear of losing eligibility for certain public assistance programs.

EFFECTIVE/OPERATIVE DATE

This bill would be effective January 1, 2016, and would be operative for taxable years beginning on or after that date.

Board Position:	S	NA	X	NP	Executive Officer	Date
	SA	O		NAR	Selvi Stanislaus	4/1/15
	N	OUA				

FEDERAL/STATE LAW

Federal Law

Qualified Tuition Programs

IRC section 529 provides specified income tax and transfer tax rules for the treatment of accounts and contracts established under qualified tuition programs.¹ A qualified tuition program is a program established and maintained by a state or agency or instrumentality thereof, or by one or more eligible educational institutions, which satisfies certain requirements and under which a person may purchase tuition credits or certificates on behalf of a designated beneficiary that entitle the beneficiary to the waiver or payment of qualified higher education expenses of the beneficiary (a “prepaid tuition program”). In the case of a program established and maintained by a state or agency or instrumentality thereof, a qualified tuition program also includes a program under which a person may make contributions to an account that is established for the purpose of satisfying the qualified higher education expenses of the designated beneficiary of the account, provided it satisfies certain specified requirements (a “savings account program”). Under both types of qualified tuition programs, a contributor establishes an account for the benefit of a particular designated beneficiary to provide for that beneficiary’s higher education expenses.

For this purpose, qualified higher education expenses means tuition, fees, books, supplies, and equipment required for the enrollment or attendance of a designated beneficiary at an eligible educational institution, and expenses for special needs services in the case of a special needs beneficiary that are incurred in connection with such enrollment or attendance. Qualified higher education expenses generally also include room and board for students who are enrolled at least half-time.

Qualified ABLE Programs

The ABLE Act of 2014² created a new type of tax-favored savings program for taxable years beginning on or after January 1, 2015, a qualified ABLE program. A qualified ABLE program is a program established and maintained by a state or agency or instrumentality thereof. A qualified ABLE program must meet the following conditions: (1) under the provisions of the program, contributions may be made to an account (an “ABLE account”), established for the purpose of meeting the qualified disability expenses of the designated beneficiary of the account; (2) the program must limit a designated beneficiary to one ABLE account; (3) the program must allow for the establishment of ABLE accounts only for a designated beneficiary who is either a resident of the state maintaining such ABLE program or a resident of a state that has not established an ABLE program (a “contracting state”) which has entered into a contract with such state to provide the contracting state’s residents with access to the state’s ABLE program; and (4) the program

¹ The term “account” refers to a prepaid tuition benefit contract or a tuition savings account established pursuant to a qualified tuition program.

² Section 102 of Division B of Public Law 113-295.

must meet certain other requirements discussed below. A qualified ABLE program is generally exempt from income tax, but is otherwise subject to the taxes imposed on the unrelated business income of tax-exempt organizations.

A designated beneficiary of an ABLE account must be an eligible individual (defined below) who is designated at the commencement of participation in the qualified ABLE program as the beneficiary of amounts paid (or to be paid) into the program. Additionally, a designated beneficiary may be a brother, sister, stepbrother or stepsister of the former designated beneficiary of the ABLE account, provided such new designated beneficiary is also an eligible individual.

Contributions to an ABLE account must be made in cash and are not deductible for federal income tax purposes. Except in the case of a rollover contribution from another account, an ABLE account must provide that it may not receive aggregate contributions during a taxable year in excess of the annual gift tax exclusion amount; for 2015, this amount is \$14,000.³ Additionally, a qualified ABLE program must provide adequate safeguards to ensure that ABLE account contributions do not exceed the limit imposed on accounts under the qualified tuition program⁴ of the state maintaining the qualified ABLE program. Amounts in the account accumulate on a tax-deferred basis (*i.e.*, income on accounts in the plan is not subject to current income tax).

A qualified ABLE program may not permit any contributor to, or designated beneficiary under, the program to direct (directly or indirectly) the investment of any contributions (or earnings thereon), and must provide separate accounting for each designated beneficiary. A qualified ABLE program may not allow any interest in the program (or any portion thereof) to be used as security for a loan.

Distributions from an ABLE account are generally includible in the distributee's income to the extent those distributions consist of earnings on the account.⁵ Distributions from an ABLE account are excludable from income to the extent that the total distribution does not exceed the qualified disability expenses of the beneficiary during the taxable year. If a distribution from an ABLE account exceeds the qualified disability expenses of the beneficiary, a pro-rata portion of the distribution is excludable from income. The portion of any distribution that is includible in income is subject to an additional 10-percent tax unless the distribution is made after the death of the beneficiary. Amounts in an ABLE account may be rolled over without income tax liability to

³ The annual gift tax exclusion amount is provided in IRC section 2503(b), and is indexed annually for inflation. In the case that contributions to an ABLE account exceed the annual limit, an excise tax in the amount of six percent of the excess contribution to such account is imposed on the designated beneficiary under IRC section 4973. Such tax does not apply in the event that the trustee of such account makes a corrective distribution of such excess amounts within the taxable year.

⁴ Rules for qualified tuition programs are contained in IRC section 529.

⁵ The rules of IRC section 72 apply in determining the portion of a distribution that consists of earnings.

another ABLÉ account for the same beneficiary⁶ or another ABLÉ account for the designated beneficiary's brother, sister, stepbrother or stepsister who is also an eligible individual.

If, during any taxable year of an eligible individual, more than one ABLÉ account exists for such individual, each such ABLÉ account other than the earliest established ABLÉ account shall cease to be an ABLÉ account as of the first day of such taxable year. In this case, the designated beneficiary of the non-qualifying ABLÉ account shall be treated as having received a distribution of the fair market value of all the non-qualifying ABLÉ account's assets on the first day of such taxable year. The provision provides the Secretary of the Treasury (herein referred to as the Secretary) with the authority to prescribe regulations to enforce the one-ABLÉ-account limitation.

A contribution to an ABLÉ account is treated as a completed gift of a present interest to the beneficiary of the account. Such contributions qualify for the per-donee annual gift tax exclusion (\$14,000 for 2015) and, to the extent of such exclusion, are exempt from the generation-skipping transfer (GST) tax. A distribution from an ABLÉ account generally is not subject to gift tax or GST tax. Those taxes apply, however, to a change of designated beneficiary during any taxable year unless, as of the beginning of the year, the new beneficiary is both an eligible individual for the taxable year and a brother, sister, stepbrother or stepsister of the former beneficiary.

Eligible Individuals

A qualified ABLÉ program may provide for the establishment of ABLÉ accounts only if those accounts have as their designated beneficiary an eligible individual. For these purposes, an eligible individual is an individual either (1) for whom a disability certification has been filed with the Secretary for the taxable year, or (2) who has been determined, for purposes of Social Security Disability Insurance benefits or Supplemental Security Income (SSI) benefits⁷ to meet the requirements relating to disability or blindness described below. A disability certification means a certification to the satisfaction of the Secretary, made by the eligible individual or the parent or guardian of the eligible individual, that the individual meets the requirements relating to disability or blindness described below and that includes a copy of the individual's diagnosis relating to the individual's relevant impairment or impairments, signed by a licensed physician.⁸

⁶ For instance, if an eligible individual were to relocate to a different state, then that individual would be allowed to roll over an ABLÉ account without income tax liability to another ABLÉ account for the same beneficiary.

⁷ These are benefits, respectively, under Title II or Title XVI of the Social Security Act.

⁸ No inference may be drawn from a disability certification for purposes of eligibility for Social Security, SSI or Medicaid benefits.

For purposes of the requirements relating to disability or blindness, the definitions of blind and disabled under the SSI program apply (“SSI definitions”).⁹ In general, an individual must be either blind or disabled, and the blindness or disability must have occurred before the date on which the individual attained age 26. An individual who has not reached age 19 during the taxable year must be blind or must be disabled under the SSI definition applicable to an individual under the age of 18.

As discussed further below, the provision provides that, not later than six months after the date of enactment, the Secretary is required to develop regulations or other guidance on certain aspects of the provision. Among these aspects are regulations, to be developed in consultation with the Commissioner of Social Security, relating to disability certifications and determinations of disability including those conditions which are deemed to have occurred prior to age 26, with limited evidence required by the individual as to this requirement.

Qualified Disability Expenses

As described above, the earnings on distributions from an ABLE account are only untaxed to the extent total distributions do not exceed the qualified disability expenses of the designated beneficiary. For these purposes, qualified disability expenses are any expenses related to the eligible individual’s blindness or disability which are made for the benefit of the designated beneficiary. Such expenses include the following expenses: education, housing, transportation, employment training and support, assistive technology and personal support services, health, prevention and wellness, financial management and administrative services, legal fees, expenses for oversight and monitoring, funeral and burial expenses, and other expenses, which are approved by the Secretary under regulations and consistent with the purposes of this provision.

Reporting Requirements

Each officer or employee having control of the qualified ABLE program (or their designees) is required to make reports to the Secretary and to the designated beneficiaries of ABLE accounts. Such reports must provide information with respect to contributions, distributions, the return of excess contributions, and other matters as required by the Secretary. In addition, for research purposes, such officers and employees shall make available to the public and provide to the Secretary, reports containing aggregate information, by diagnosis and other relevant characteristics, on contributions and distributions.

⁹ Section 1614(a)(2) and (a)(3) of the Social Security Act. Under the applicable definition, an individual is generally disabled if unable to engage in any substantial gainful activity by reason of any medically determinable physical or mental impairment that can be expected to result in death or that has lasted or can be expected to last for a continuous period of at least 12 months. An individual under the age of 18 is disabled if having a medically determinable physical or mental impairment that results in marked and severe functional limitations and that can be expected to result in death or that has lasted or can be expected to last for a continuous period of at least 12 months.

However, an item of information may not be made publically available if it can be associated with, or otherwise identify, directly or indirectly, a particular individual.

The trustee of an ABLÉ account is required to submit a notice to the Secretary upon the establishment of the ABLÉ account. Such notice shall contain the name and state of residence of the beneficiary, and other such information as the Secretary may require. These reports and notices must be filed at such time and in such manner as required by the Secretary. A penalty of \$50 may apply with respect to any failure to provide a required report or notice.

Additionally, for purposes of the rules relating to eligibility for SSI, officers and employees having control of a qualified ABLÉ program must submit statements on distributions from all ABLÉ accounts to the Commissioner of the Social Security Administration, and the statements must be submitted electronically on at least a monthly basis in the manner specified by the Commissioner.

Transfer to State

In the event that the designated beneficiary dies, subject to any outstanding payments due for qualified disability expenses incurred by the designated beneficiary, all amounts remaining in the deceased beneficiary's ABLÉ account not in excess of the amount equal to the total medical assistance paid such individual under any state Medicaid plan established under title XIX of the Social Security Act shall be distributed to such state upon filing of a claim for payment by such state. Such repaid amounts shall be net of any premiums paid from the account or by or on behalf of the beneficiary to a Medicaid Buy-In Program.

Regulations

The Secretary is directed to issue regulations or other guidance as the Secretary determines is necessary or appropriate to carry out the purposes of the qualified ABLÉ program rules, including regulations (1) to enforce the one-ABLE-account-per-eligible-individual limit; (2) providing for the information required to be presented to open an ABLÉ account; (3) to generally define disability expenses; (4) relating to disability certifications and determinations of disability, to be developed in consultation with the Commissioner of Social Security, as discussed above; (5) to prevent fraud and abuse with respect to amounts claimed as qualified disability expenses; (6) under the estate tax, gift tax, and generation-skipping transfer tax provisions of the IRC; and (7) to allow for transfers from one ABLÉ account to another ABLÉ account in cases in which an eligible individual has a change in state of residence. The Secretary is directed to issue such regulations or other guidance no later than six months after December 19, 2014.¹⁰

¹⁰ On March 10, 2015, the IRS issued Notice 2015-18 to announce that the Treasury Department and the IRS are currently working on IRC section 529A guidance but anticipate that ABLÉ programs may be in operation in some states before the guidance is issued, and issued the notice to assure states that enact legislation creating an ABLÉ program in accordance with IRC section 529A, and those individuals establishing ABLÉ accounts in accordance with such legislation, that they will not fail to receive the benefits of IRC section 529A merely because the legislation or the account documents do not fully comport with the guidance when it is issued. The Treasury Department and the IRS intend to provide transition relief with regard to necessary changes to ensure that the state programs and accounts meet the requirements in the guidance.

Treatment of ABLE Accounts under Certain Federal Programs

Notwithstanding any other provision of federal law that requires the consideration of one or more financial circumstances of an individual, for the purpose of determining eligibility to receive, or the amount of, any assistance or benefit authorized by such provision to be provided to or for the benefit of such individual, any amount (including earnings) in an ABLE account of the individual, any contributions to an ABLE account of the individual, and any distribution for qualified disability expenses are required to be disregarded for purposes of determining such eligibility during any period in which the individual maintains, makes contributions to, or receives distributions from an ABLE account, except that in the case of the SSI program—a distribution for housing expenses is not disregarded, and any amount in an ABLE account in excess of \$100,000 is considered a resource for the designated beneficiary.

California Law

California generally conforms to qualified tuition programs under IRC section 529,¹¹ but does not conform to the ABLE provisions under IRC section 529A.

THIS BILL

This bill would establish a California ABLE program,¹² and would generally conform to the federal income tax treatment of ABLE accounts.

The California ABLE program would allow a person to make contributions for a taxable year for the benefit of an individual who is an eligible individual for that taxable year to an ABLE account that is established for the purpose of meeting the qualified disability expenses of the account. The designated beneficiary would be required to be a resident of this state, and would be allowed to have only one ABLE account.

Similar to federal law, contributions would be required to be made in cash and would not be deductible for state income tax purposes, and the additional federal contribution, rollover, and distribution rules would apply—meaning the portion of any ABLE distribution that is includible in income would be subject to an additional 10-percent tax for state purposes (in addition to the 10-percent additional tax imposed for federal purposes), unless the distribution is made after the death of the designated beneficiary.

¹¹ R&TC sections 17140.3 and 23711.

¹² The California ABLE program and fund would be established under the California Welfare and Institutions Code, and would be administered by the California State Treasurer, who would be responsible to ensure that the program is administered in compliance with the federal ABLE Act.

This bill would not conform to the federal six-percent excise tax on contributions to an ABLE account that exceed the annual limit, and would not require that ABLE account amounts¹³ be disregarded for purposes of determining eligibility for state and local means-tested programs that provide assistance to disabled individuals.

A copy of the report required to be filed with the Secretary of the Treasury under IRC section 529A(g) would be required to be filed with the Franchise Tax Board at the same time and in the same manner as specified by the Secretary.¹⁴

IMPLEMENTATION CONSIDERATIONS

This bill would not significantly impact the department's programs or operations.

TECHNICAL CONSIDERATIONS

Minor technical amendments are suggested.

LEGISLATIVE HISTORY

AB 449 (Irwin, et al., 2015/16) is substantially similar to this bill, except that it would provide that ABLE account amounts would be required to be disregarded for purposes of determining eligibility for state and local means-tested programs that provide assistance to disabled individuals. AB 449 is currently in 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. A review of these states' laws found that most are in the process of enacting state legislation to establish ABLE programs in their state, and are generally planning to allow enrollment in their ABLE programs beginning in late 2015.

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.

¹³ "ABLE account amounts" includes any amount (including earnings) in an ABLE account, any contributions to an ABLE account, and any distribution for qualified disability expenses.

¹⁴ There is a technical modification suggested to refer to the report required to be filed with the Secretary of the Treasury under IRC section 529A(d) instead of IRC section 529A(g).

ECONOMIC IMPACT

Revenue Impact

Estimated Revenue Impact of SB 324 As Introduced February 23, 2015 Assumed Enactment After June 30, 2015		
2015-16	2016-17	2017-18
- \$100,000	- \$400,000	- \$900,000

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

Revenue Discussion

This estimate is based on a proration of the Joint Committee on Taxation (JCT) estimate for the ABLE Act of 2014. The JCT's estimated losses, converted to calendar years, are \$5.5 million, \$13.5 million, \$30.3 million, and \$57.3 million in calendar years 2016, 2017, 2018, and 2019, respectively. These estimated losses are attributable to projected earnings in ABLE accounts that are exempt from taxation and distributions that do not exceed qualified expenses that are excluded from gross income.

The JCT estimated losses are reduced by approximately 87.5 percent based on Social Security Disability Insurance data to reflect California's estimated share of the federal exclusion. The results are then reduced an additional 70 percent to reflect the difference between federal and state tax rates.

The calendar-year estimates are converted to fiscal years and then rounded to arrive at the amounts shown in the table above. The JCT estimates that revenue losses are projected to continue to increase, and prorating the last year included in the JCT estimate would result in an estimated loss of approximately \$10 million in fiscal year 2025-26.

SUPPORT/OPPOSITION

Support: Autism Speaks and the National Down Syndrome Society.

Opposition: None on file.

ARGUMENTS

Proponents: Those in support of this bill may argue that it would help alleviate the substantial financial challenges of caring for disabled individuals.

Opponents: Those in opposition to this bill may argue that this bill should offer additional incentives to assist with the financial challenges of caring for disabled individuals.

POLICY CONCERNS

This bill would provide that the portion of any distribution that is includible in state income would be subject to an additional 10-percent tax for state purposes (in addition to the 10-percent additional tax imposed for federal purposes), unless the distribution is made after the death of the beneficiary. The author may want to consider reducing the additional tax rate to be generally proportional to the difference between federal and state tax rates; for example, California generally modifies the 10-percent tax on nonqualified pension distributions to be a 2.5 percent additional tax for state purposes.

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PROPOSED AMENDMENTS TO
SB 324, AS INTRODUCED FEBRUARY 23, 2015

AMENDEMENT 1

On page 2, line 4, ~~enacted by Section 102 of~~, and insert:
added by Section 102 of Division B of

AMENDEMENT 2

On page 2, lines 15-16, ~~Section 529A(g) of the Internal Revenue Code~~, and insert:
Section 529A(d) of the Internal Revenue Code, relating to reports,

AMENDEMENT 3

On page 2, line 20, ~~enacted by Section 102 of~~, and insert:
added by Section 102 of Division B of

AMENDEMENT 4

On page 2, lines 30-31, ~~Section 529A(g) of the Internal Revenue Code~~, and insert:
Section 529A(d) of the Internal Revenue Code, relating to reports,