

BILL ANALYSIS

Department, Board, Or Commission Franchise Tax Board	Authors Pavley, et al.	Bill Number SB 324
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SUBJECT

The California Achieving a Better Life Experience (ABLE) Act

SUMMARY

This bill would generally conform to the federal tax treatment of ABLE accounts.

This report only addresses the provisions of the bill that would impact the department's programs and operations.

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 January 1, 2016, only if Assembly Bill 449 (Irwin, et al., 2015/16) is enacted.

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. 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.

Gail Hall, FTB Contact Person
(916) 845-6333 (Office)

Executive Officer
Selvi Stanislaus

Date
9/14/15

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 2014¹ 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 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 \$14,000.² 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 program³ 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).

¹ Section 102 of Division B of Public Law 113-295.

² 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.

³ Rules for qualified tuition programs are contained in IRC section 529.

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.⁴ 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 another ABLE account for the same beneficiary⁵ or another ABLE 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 ABLE account exists for such individual, each such ABLE account other than the earliest established ABLE account shall cease to be an ABLE account as of the first day of such taxable year. In this case, the designated beneficiary of the non-qualifying ABLE account shall be treated as having received a distribution of the fair market value of all the non-qualifying ABLE 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-ABLE-account limitation.

A contribution to an ABLE 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 ABLE 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 ABLE program may provide for the establishment of ABLE 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) benefits⁶ to meet

⁴ The rules of IRC section 72 apply in determining the portion of a distribution that consists of earnings.

⁵ For instance, if an eligible individual were to relocate to a different state, then that individual would be allowed to roll over an ABLE account without income tax liability to another ABLE account for the same beneficiary.

⁶ These are benefits, respectively, under Title II or Title XVI of the Social Security Act.

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.⁷

For purposes of the requirements relating to disability or blindness, the definitions of blind and disabled under the SSI program apply ("SSI definitions").⁸ 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.

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: 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.

⁷ No inference may be drawn from a disability certification for purposes of eligibility for Social Security, SSI or Medicaid benefits.

⁸ 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.

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.

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 ABLE account is required to submit a notice to the Secretary upon the establishment of the ABLE 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.

California Law

California generally conforms to qualified tuition programs under IRC section 529,⁹ but does not conform to the ABLE provisions under IRC section 529A.

THIS BILL

This bill would generally conform to the federal tax treatment of ABLE accounts.

Similar to federal law, contributions to ABLE accounts would be required to be made in cash and would not be deductible for state purposes, and the additional federal contribution, rollover, and distribution rules would generally apply, modified to provide that any ABLE distribution that is includible in income would be subject to an additional 2.5-percent tax for state purposes (in lieu of the 10-percent additional tax that is imposed for federal purposes), unless the distribution is made after the death of the designated beneficiary.

A copy of the report that each officer or employee having control of the qualified ABLE program or their designee that would be required to file with the Secretary of the Treasury with respect to contributions, distributions, the return of excess contributions, and other matters required by the Secretary, would also be required to be filed with the Franchise Tax Board (FTB) at the same time and in the same manner as specified by the Secretary.

⁹ R&TC sections 17140.3 and 23711.

The California ABLE Act Board would be required to provide to the FTB an annual listing of distributions to individuals with respect to an interest in an ABLE account, and make a report to the appropriate individual of any distribution to any individual with respect to an interest in an ABLE account, at the times and in a form and manner as specified or required by the FTB. Taxpayers' identification numbers obtained in connection with an ABLE account would be required to be used exclusively for state and federal tax administration purposes.

This bill would only become effective if Assembly Bill 449 (Irwin, et al., 2015/16) is enacted and becomes effective.

LEGISLATIVE HISTORY

AB 449 (Irwin, et al., 2015/16) is substantially similar to this bill. AB 449 went to enrollment on September 9, 2015.

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

This bill would not significantly impact the department's costs.

ECONOMIC IMPACT

Revenue Impact

Estimated Revenue Impact of SB 324 Assumed Enactment After June 30, 2015		
2015-16	2016-17	2017-18
- \$150,000	- \$400,000	- \$1,000,000

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, with an additional adjustment to reflect the 7.5-percent difference between federal and state additional tax rates that would apply to nonqualified distributions.

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.

APPOINTMENTS

None.

SUPPORT/OPPOSITION¹⁰

Support: Board of Governors of the California Community Colleges, California Association for Health Services at Home, California Foundation for Independent Living Centers, California Taxpayers Association, North Los Angeles County Regional Center, State of California, Treasurer, and the State Council on Developmental Disabilities.

Opposition: None on file.

VOTES

	Date	Yes	No
Concurrence	09/10/15	40	0
Assembly Floor	09/08/15	79	0
Senate Floor	06/01/15	40	0

LEGISLATIVE STAFF CONTACT

Contact	Work
Marybel Batjer, Agency Secretary, GovOps	916-651-9024
Jennifer Osborn, Deputy Secretary, Fiscal Policy and Administration, GovOps	916-651-9100
Selvi Stanislaus, Executive Officer, FTB	916-845-4543
Gail Hall, Legislative Director, FTB	916-845-6333

¹⁰ From the July 10, 2015, Assembly Committee on Revenue and Taxation bill analysis.