

ANALYSIS OF AMENDED BILL

Author: Scott Analyst: John J. Pavalasky Bill Number: AB 1613

Related Bills: _____ Telephone: 845-4335 Amended Date: 1/15/98

Attorney: Doug Bramhall Sponsor: _____

SUBJECT: Conformity/Education Loan Interest Deduction/ HOPE credit/ Higher Education Affordability Act

DEPARTMENT AMENDMENTS ACCEPTED. Amendments reflect suggestions of previous analysis of bill as introduced/amended _____.

AMENDMENTS IMPACT REVENUE. A new revenue estimate is provided.

AMENDMENTS DID NOT RESOLVE THE DEPARTMENT'S CONCERNS stated in the previous analysis of bill as introduced/amended _____.

FURTHER AMENDMENTS NECESSARY.

DEPARTMENT POSITION CHANGED TO _____.

REMAINDER OF PREVIOUS ANALYSIS OF BILL AS INTRODUCED/AMENDED _____ STILL APPLIES.

OTHER - See comments below.

SUMMARY OF BILL

This bill would partially conform California law to the federal non-refundable HOPE and lifetime learning credit, conform to the deduction for interest on certain education loans, and conform to the modifications and clarifications of the rules relating to qualified state tuition programs contained in the federal 1997 Taxpayer Relief Act (Public Law 105-34).

SUMMARY OF AMENDMENT

The January 5, 1998, amendment deletes the bill's prior language regarding the California Transportation Commission and insert the language discussed in this analysis.

The January 15, 1998, amendment reduces the allowable percentage for the HOPE and lifetime learning credits.

EFFECTIVE DATE

This bill as a tax levy would go into immediate effect and, in general, be operative for taxable years beginning on or after January 1, 1998. The HOPE credit applies only with respect to expenses paid after December 31, 1997, in taxable years ending after that date, for education furnished in academic periods

DEPARTMENTS THAT MAY BE AFFECTED:

___ STATE MANDATE

___ GOVERNOR'S APPOINTMENT

Department Director Position:

___ S ___ O
___ SA ___ OUA
___ N ___ NP
___ NA ___ NAR
___ X PENDING

Agency Secretary Position:

___ S ___ O
___ SA ___ OUA
___ N ___ NP
___ NA ___ NAR
DEFER TO _____

GOVERNOR'S OFFICE USE

Position Approved ___
Position Disapproved ___
Position Noted ___

Department/Legislative Director Date
Gerald H. Goldberg 1/10/98

Agency Secretary Date

By: Date:

beginning after that date. However, the lifetime learning credit applies only with respect to expenses paid after June 30, 1998, in taxable years ending after that date, for education furnished in academic periods beginning after that date.

LEGISLATIVE HISTORY

AB 530 (Stats. 1997, Ch. 851)

SPECIFIC FINDINGS

1. HOPE and Lifetime Learning Credit

Federal Law

Individual taxpayers are allowed to claim a non-refundable HOPE credit or lifetime learning credit against federal income taxes. The HOPE credit rate is 100% on the first \$1,000 of qualified tuition and fees, and 50% on the next \$1,000 of qualified tuition and fees. The lifetime learning credit is 20% of the first \$5,000 (increased to \$10,000 per student in 2003) of qualified tuition and fees per taxpayer. Both the HOPE and the lifetime learning credit are available only for tuition and fees required for the enrollment or attendance of an eligible student at an eligible institution and are not available for expenses incurred to purchase books or for room and board. For each taxable year, a taxpayer must elect with respect to an eligible student either the HOPE credit, the lifetime learning credit, or the exclusion from gross income for certain distributions from an education IRA.

Neither the HOPE nor the lifetime learning credit is available to married taxpayers filing separate returns. Married taxpayers must file joint tax returns to qualify for the credits.

A. HOPE credit

The HOPE credit is for tuition and fees paid for the first two years of the student's post-secondary education in a degree or certificate program. The qualified tuition and related expenses must be incurred on behalf of the taxpayer, the taxpayer's spouse, or a dependent. Beginning in 2001, the maximum credit amount of \$1,500 will be indexed for inflation, rounded down to the closest multiple of \$50.

The HOPE credit may not be claimed against a taxpayer's alternative minimum tax (AMT) liability. The HOPE credit amount that a taxpayer may otherwise claim is phased out ratably for taxpayers with modified AGI between \$40,000 and \$50,000 (\$80,000 and \$100,000 for joint returns). Modified AGI includes amounts otherwise excluded with respect to income earned abroad (or income from Puerto Rico or U.S. possessions). The income phase-out ranges will be indexed for inflation occurring after the year 2000, rounded down to the closest multiple of \$1,000. The HOPE credit is available in the taxable year the expenses are paid, subject to the requirement that the education commence or continue during that year or during the first three months of the next year. Qualified tuition expenses paid with the proceeds of a loan generally are eligible for the HOPE credits (rather than repayment of the loan itself).

The Treasury Department is granted authority to issue regulations providing that the HOPE credit will be recaptured in cases where the student or taxpayer receives a refund of tuition and related expenses with respect to which a credit was claimed in a prior year.

If a student is claimed as a dependent by the parent or other taxpayer, the eligible student is not entitled to claim a HOPE credit for that taxable year on the student's own tax return. If a parent (or other taxpayer) claims a student as a dependent, any qualified tuition and related expenses paid by the student are treated as paid by the parent (or other taxpayer) for purposes of this provision.

For each taxable year, a taxpayer may elect with respect to an eligible student either the HOPE credit, the lifetime learning credit, or the exclusion from gross income for certain distributions from an education IRA. Thus, for example, if a parent claims a child as a dependent for a taxable year, then all qualified tuition expenses paid by both the parent and child are deemed paid by the parent, and the parent may claim the HOPE credit (assuming that the AGI phaseout does not apply) on the parent's return.

- Qualified Tuition and Fees

The HOPE credit is available for "qualified tuition and related expenses," meaning tuition and fees required for the enrollment or attendance of an eligible student at an eligible educational institution, as defined. The credit is not available for expenses incurred to purchase books. Charges and fees associated with meals, lodging, student activities, athletics, insurance, transportation, and similar personal, living or family expenses are also not included. The expenses of education involving sports, games, or hobbies are not qualified tuition and related expenses unless this education is part of the student's degree program.

Qualified tuition and fees generally include only out-of-pocket expenses. Qualified tuition and fees do not include expenses covered by educational assistance that is not required to be included in the gross income of either the student or the taxpayer claiming the credit. Thus, total qualified tuition and fees are reduced by any scholarship or fellowship grants excludable from gross income under present-law and any other tax-free educational benefits received by the student during the taxable year. No reduction of qualified tuition and fees is required for a gift, bequest, devise, or inheritance. A HOPE credit is not allowed with respect to any education expense for which a deduction is claimed as a business expense or under any other section of the Internal Revenue Code.

- Coordination with U.S. Savings Bonds

The TRA of 1997 amended the exclusion from income of interest earned from federal savings bonds if used for higher education to provide that the amount of qualified higher education expenses taken into account for that purpose is reduced by the amount of the expenses taken into account in determining the HOPE credit or the lifetime

learning credit claimed by any taxpayer with respect to the student for the taxable year.

- Eligible Student

An eligible student for purposes of the HOPE credit is an individual who is enrolled in a degree, certificate, or other program (including a program of study abroad approved for credit by the institution at which such student is enrolled) leading to a recognized educational credential at an eligible educational institution. The student must pursue a course of study for at least one academic period which begins during the taxable year and must carry at least one-half the normal full-time work load for the course of study the student is pursuing. In addition, an eligible student may not have been convicted of a federal or state felony consisting of the possession or distribution of a controlled substance.

- Eligible Educational Institutions

Eligible educational institutions are defined by reference to section 481 of the Higher Education Act of 1965. Such institutions generally are accredited post-secondary educational institutions offering credit toward a bachelor's degree, an associate's degree, or another recognized post-secondary credential. Certain proprietary institutions and post-secondary vocational institutions also are eligible educational institutions. The institution must be eligible to participate in Department of Education student aid programs.

B. Lifetime Learning Credit

Taxpayers may claim a non-refundable lifetime learning credit against federal income taxes equal to 20% of qualified tuition and fees incurred during the taxable year on behalf of the taxpayer, the taxpayer's spouse, or any dependents. For expenses paid after June 30, 1998, and prior to January 1, 2003, up to \$5,000 of qualified tuition and fees per taxpayer return will be eligible for the 20% lifetime learning credit (i.e., the maximum credit per taxpayer return will be \$1,000). For expenses paid after December 31, 2002, up to \$10,000 of qualified tuition and fees per taxpayer return will be eligible for the 20% lifetime learning credit (i.e., the maximum credit per taxpayer return will be \$2,000). In contrast to the HOPE credit, a taxpayer may claim the lifetime learning credit for an unlimited number of taxable years. Also in contrast to the HOPE credit, the maximum amount of the lifetime learning credit that may be claimed on a taxpayer's return will not vary based on the number of students in the taxpayer's family. The lifetime learning credit is phased out ratably over the same phase-out range that applies for purposes of the HOPE credit--i.e., taxpayers with modified AGI between \$40,000 and \$50,000 (\$80,000 and \$100,000 for joint returns). The income phase-out ranges will be indexed for inflation occurring after the year 2000, rounded down to the closest multiple of \$1,000.

The lifetime learning credit is available in the taxable year the expenses are paid, subject to the requirement that the education commence or continue during that year or during the first three months of the next year. Qualified tuition and fees paid with the proceeds of a loan generally are

eligible for the lifetime learning credit (rather than repayment of the loan itself).

- Dependent Students

As with the HOPE credit, a taxpayer may claim the lifetime learning credit with respect to a student who is not the taxpayer or the taxpayer's spouse (e.g., in cases where the student is the taxpayer's child) only if the taxpayer claims the student as a dependent for the taxable year for which the credit is claimed. If a parent (or other taxpayer) claims a student as a dependent, any qualified tuition and related expenses paid by the student are treated as paid by the parent (or other taxpayer) for purposes of this provision and, as with the HOPE credit, the student is not entitled to the credit on the student's own tax return.

- Election of Lifetime Learning Credit

For each taxable year, a taxpayer may elect with respect to an eligible student either the HOPE credit, the lifetime learning credit, or the exclusion from gross income for certain distributions from an education IRA.

- Qualified Tuition and Fees

The lifetime learning credit is available for "qualified tuition and fees," meaning tuition and fees required for the enrollment or attendance of the eligible student at an eligible institution. Qualified tuition and fees are defined in the same manner as under the HOPE credit provisions.

- Eligible Educational Institutions

Eligible educational institutions are (as with the HOPE credit) defined by reference to section 481 of the Higher Education Act of 1965.

- Regulations

The Secretary of the Treasury (in consultation with the Secretary of Education) is granted authority to issue regulations to implement the provision. The Secretary of the Treasury will have authority to issue regulations providing appropriate rules for recordkeeping and information reporting. These regulations may address the information reports that eligible educational institutions will be required to file to assist students and the IRS in calculating the amount of the lifetime learning credit potentially available.

California Law

California currently has no comparable credit.

This bill would partially conform to the federal HOPE and lifetime learning credit by allowing a non-refundable credit equal to a HOPE credit for 25% of

qualified tuition and related expenses paid by the taxpayer during the taxable year (for education furnished to the eligible student during any academic period beginning in that year) that exceed \$1,000 (as adjusted for inflation) and do not exceed \$2,000 (as adjusted for inflation), plus a lifetime learning credit for 5% of qualified tuition and related expenses (up to a lifetime aggregate of \$5,000) paid by the taxpayer during the taxable year.

The \$5,000 lifetime aggregate limit is increased to a lifetime aggregate limit of \$10,000 in taxable years beginning on or after January 1, 2003.

This bill conforms to the federal rules relating to eligibility for and determination of the amount of these credits and, in addition, specifies that the lifetime learning credit is not allowed to be claimed on the state return with respect to a student for which the taxpayer has claimed the federal 100% HOPE credit for the same taxable year.

2. Deduction for interest on education loans

Background

The Tax Reform Act of 1986 repealed the deduction for personal interest. Student loan interest generally is treated as personal interest and thus is not allowable as an itemized deduction. Taxpayers, in general, may not deduct education and training expenses. However, a deduction for education expenses is allowed as a trade or business expense if the education or training (1) maintains or improves a skill required in a trade or business currently engaged in by the taxpayer, or (2) meets the express requirements of the taxpayer's employer, or requirements of applicable law or regulations, imposed as a condition of continued employment. Education expenses are not deductible if they relate to certain minimum educational requirements or to education or training that enables a taxpayer to begin working in a new trade or business. In the case of an employee, education expenses (if not reimbursed by the employer) may be claimed as an itemized deduction only if such expenses relate to the employee's current job and only to the extent that the expenses, along with other miscellaneous deductions, exceed 2% of the taxpayer's adjusted gross income (AGI).

Federal Law

Under the TRA of 1997, certain individuals who have paid interest on qualified education loans may claim an above-the-line deduction for such interest expenses, up to a maximum deduction of \$2,500 for the 2001 taxable year. The maximum deduction is phased in over four years, with a \$1,000 maximum deduction in 1998, \$1,500 in 1999, \$2,000 in 2000, and \$2,500 in 2001. The maximum deduction amount is not indexed for inflation.

In addition, the deduction is phased out ratably for individual taxpayers with modified AGI of \$40,000-\$55,000 (\$60,000-\$75,000 for joint returns).

The deduction is allowed only with respect to interest paid on a qualified education loan during the first 60 months in which interest payments are required. Months during which the qualified education loan is in deferral or forbearance do not count against the 60-month period. No deduction is

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 as defined in section 472 of the Higher Education Act of 1965 (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 IRA 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.

California Law

California law generally is in conformity with the Internal Revenue Code as it read on January 1, 1997, as it relates to educational incentives, which did not allow a deduction for student loan interest.

This bill would allow a deduction for the interest paid by the taxpayer during the taxable year on any qualified education loan up to the following maximum amounts:

<u>Taxable Year</u>	<u>Maximum</u>
1998	\$1,000
1999	\$1,500
2000	\$2,000
2001 or thereafter	\$2,500

3. Modifications of qualified state tuition programs

Background

Internal Revenue Code Section 529 (enacted as part of the Small Business Job Protection Act of 1996) provides tax-exempt status to "qualified state tuition programs," meaning certain programs established and maintained by a state (or agency or instrumentality thereof) under which persons may (1) purchase tuition credits or certificates on behalf of a designated beneficiary that entitle the beneficiary to a waiver or payment of qualified higher education expenses of the beneficiary, or (2) make contributions to an account that is established for the purpose of meeting qualified higher education expenses of the designated beneficiary of the account.

"Qualified higher education expenses" are defined as tuition, fees, books, supplies, and equipment required for the enrollment or attendance at a college or university (or certain vocational schools). Prior to the 1997

Taxpayer Relief Act, qualified higher education expenses did not include room and board expenses. That section also provides that no amount shall be included in the gross income of a contributor to, or beneficiary of, a qualified state tuition program with respect to any distribution from, or earnings under, such program, except that (1) amounts distributed or educational benefits provided to a beneficiary (e.g., when the beneficiary attends college) will be included in the beneficiary's gross income (unless excludable under another Code section) to the extent such amounts or the value of the educational benefits exceed contributions made on behalf of the beneficiary, and (2) amounts distributed to a contributor (e.g., when a parent receives a refund) will be included in the contributor's gross income to the extent such amounts exceed contributions made by that person. Specifically, section 529(c)(3)(A) provides that any distribution under a qualified State tuition program shall be includible in the gross income of the distributee in the same manner as provided under present-law Internal Revenue Code section 72 to the extent not excluded from gross income under any other provision of the Internal Revenue Code.

Federal Law

The 1997 Taxpayer Relief Act made the following modifications and clarifications to Section 529 of the Internal Revenue Code, which governs the tax treatment of qualified State tuition programs.

- Room and board expenses -- Expands the definition of "qualified higher education expenses" to include room and board expenses (meaning the minimum room and board allowance applicable to the student as determined by the institution in calculating costs of attendance for federal financial aid programs under section 472 of the Higher Education Act of 1965) for any period during which the student is at least a half-time student.
- Eligible educational institution -- Expands the definition by defining the term by reference to section 481 of the Higher Education Act of 1965.

Such institutions generally are accredited post-secondary educational institutions offering credit toward a bachelor's degree, an associate's degree, a graduate-level or professional degree, or another recognized post-secondary credential. Certain proprietary institutions and post-secondary vocational institutions also are eligible institutions. The institution must be eligible to participate in Department of Education student aid programs.

- Member of family -- Expands the definition of family member for purposes of allowing tax-free transfers or rollovers of credits or account balances in qualified state tuition programs (and redesignations of named beneficiaries), so that the term means, with respect to the taxpayer, a son or daughter or descendent of either, a stepson or stepdaughter, a brother, sister, stepbrother, or stepsister, the father, mother, or ancestor of either, a stepfather or stepmother, nephews, nieces, aunts, uncles, and certain in-laws as well as the spouse of any of these persons.

The 1997 Taxpayer Relief Act also provides a special rule that, in the case of any contract executed prior to August 20, 1996 (i.e., the date of enactment of Section 529), that section will be applied without regard to the requirement that a distribution be transferred to a member of the family or the requirement that a change in beneficiaries may be made only to a member of the family.

- Prohibition against investment direction-- Clarifies the present-law rule that qualified state tuition programs may not allow contributors or designated beneficiaries to direct the investment of contributions to the program (or earnings thereon) by specifically providing that contributors and beneficiaries may not "directly or indirectly" direct the investment of contributions to the program (or earnings thereon).
- Interaction with HOPE credit and Lifetime Learning credit-- Under the 1997 Taxpayer Relief Act (as under present law the earnings portion of the distribution from a qualified state tuition program (whether made in cash or in-kind) will be includible in the gross income of the distributee. However, to the extent that a distribution from a qualified state tuition program is used to pay for qualified tuition and fees, the distributee (or another taxpayer claiming the distributee as a dependent) will be able to claim the HOPE credit or lifetime learning credit provided for by the 1997 Taxpayer Relief Act with respect to such tuition and fees (assuming that the other requirements for claiming the HOPE credit or lifetime learning credit are satisfied).

In cases where in-kind benefits are provided to a beneficiary under a qualified state prepaid tuition program, the provision of such benefits is treated as a distribution to the beneficiary. Thus, to the extent such in-kind benefits, if paid for by the beneficiary, would constitute payment of qualified tuition and fees for purposes of the HOPE credit or lifetime learning credit, the beneficiary (or another taxpayer claiming the beneficiary as a dependent) may be able to claim the HOPE credit or lifetime learning credit with respect to payments that are deemed to be made by the beneficiary with respect to the in-kind benefit.

- Federal estate and gift tax -- Any contribution to a qualified tuition program or education IRA will be treated as a completed gift of a present interest from the contributor to the beneficiary at the time of the contribution. Thus, contributions made to a qualified tuition program and/or education investment account will be eligible for the present law annual gift tax exclusion and also will be excludable for purposes of the generation-skipping transfer tax (provided that the contribution, when combined with any other contributions made by the donor to that same beneficiary, does not exceed the annual gift-tax exclusion limit of \$10,000 in the case of an individual or \$20,000 in the case of a married couple that elects to split their gifts). Contributions to a qualified tuition program (either a state-sponsored program or one maintained by a private education institution) or to an education IRA will not, however, be eligible for the educational expense exclusion. In no event will a distribution from a qualified tuition program or education investment account be treated as a

taxable gift.

A special rule is provided in the case of contributions that exceed the indexed annual gift tax exclusion limit (currently \$10,000 for individuals). For such contributions, the contributor may elect to have the contribution treated as if made ratably over a five-year period. Under this rule, a donor currently may contribute up to \$50,000 every five years (\$100,000 in the case of a married couple that elects gift splitting) with no gift tax consequences, assuming no other gifts are made from the donor to the beneficiary during the five-year period. A gift tax return must be filed with respect to any contribution in excess of the annual gift-tax exclusion limit, and the election for five-year averaging must be made on the contributor's gift tax return.

If a donor making an over-\$10,000 contribution dies during the five-year averaging period, the portion of the contribution that has not been allocated to the years prior to death is includible in the donor's estate.

If a beneficiary's interest is rolled over to another beneficiary, there are no transfer tax consequences if the two beneficiaries are in the same generation. If a beneficiary's interest is rolled over to a beneficiary in a lower generation (e.g., parent to child or uncle to niece), the five-year averaging rule described above may be applied to exempt up to \$50,000 of the transfer from gift tax.

The federal estate and gift tax treatment of educational accounts has no effect on the actual rights and obligations of the parties pursuant to the terms of the contracts under State law.

Transfers or rollovers of credits or account balances from an account benefiting one beneficiary to an account benefiting another beneficiary (or a change in the designated beneficiary) will not be treated as a taxable gift to the extent that the new beneficiary is: (1) a member of the family of the old beneficiary (as defined above), and (2) assigned to the same generation as the old beneficiary (within the meaning of Internal Revenue Code section 2651). In all other cases, a transfer from one beneficiary to another beneficiary (or a change in the designated beneficiary) will be treated as a taxable gift from the old beneficiary to the new beneficiary to the extent it exceeds the \$10,000 present-law annual gift tax exclusion. Thus, a transfer of an account from a brother to his sister will not be treated as a taxable gift, whereas a transfer from a father to his son will be treated as a taxable gift (to the extent it exceeds the \$10,000 present-law gift tax exclusion).

For estate tax purposes, the value of any interest in a qualified tuition program or education investment account will be includible in the estate of the designated beneficiary. In no event will such interests be includible in the estate of the contributor.

California Law

AB 530 (Stat. 1997, Ch. 851), under the Education Code, created the Golden State Scholarshare Trust, effective for taxable years beginning on or after January 1, 1998. (The Golden State Scholarshare was designed to meet the requirements of Section 529 of the Internal Revenue Code as a state-sponsored qualified tuition program.) The Revenue and Taxation Code was modified to make the Scholarshare trust tax exempt and earnings on the deposits to the trust non-taxable to the participant or beneficiary until the earnings are distributed. AB 530 states under uncodified law that it is the intent of the Legislature that the Golden State Scholarshare program be maintained as a qualified state tuition program as provided in Section 529 of the Internal Revenue Code. Further, AB 530 is to be applied in a manner consistent with Section 529 of the Internal Revenue Code and any ambiguities shall be resolved consistent with Section 529 of the Internal Revenue Code.

This bill would conform the Revenue and Taxation Code to the federal modifications and clarifications governing the income tax treatment of qualified state tuition programs.

Since California has no gift tax and the state estate tax is a "pick-up" tax (i.e. the tax is equal to the maximum federal credit for state estate tax allowed on the federal estate tax return for that decedent), the federal estate and gift tax modifications do not apply to California.

Policy Considerations

Most credits are enacted with a sunset date so the Legislature may review their effectiveness. The HOPE credit and lifetime learning credit do not contain a sunset date.

Implementation Considerations

Federal law allows the deduction for interest on education loans to be taken in computing adjusted gross income (AGI). Thus, all taxpayers paying this type of interest receive the benefit of the deduction, not only those who have itemized deductions which exceed the standard deduction. This is known as an above-the-line deduction. As an above-the-line deduction on the federal return, this interest deduction will appear on a significant number of the most simple returns (i.e. the 1040EZ and TELEFILE returns) of former students entering the work force in entry-level positions.

The California return begins with federal AGI. Since the bill currently does not contain language which would allow this same above-the-line treatment for state purposes, an adjustment to federal AGI would be required as well as allowing this deduction as an itemized deduction. Those adjustments can be made only on the long Form 540. Thus, those taxpayers who previously were eligible to file the most simple state returns (i.e. 540EZ and TELEFILE returns) would now be required to file the long form 540 to take this deduction as an itemized deduction instead of an above-the-line deduction.

Technical Considerations

In subdivision (c) of Section 17053.51 as added by this bill, the reference to "Section 25A(c)(2)(A)" should instead read "Section 25A(c)(2)(A) of the Internal Revenue Code".

FISCAL IMPACT

Departmental Costs

If the implementation consideration is resolved, this bill would not significantly impact the department's costs.

Tax Revenue Estimate

Revenue losses from this provision are estimated as follows:

Estimated Revenue Impact of AB 1613			
Taxable Years Beginning 1/1/98			
Assumed Enactment After 6/30/98			
	1998-9	1999-0	2000-01
Hope Credit	(\$18)	(\$14)	(\$14)
Lifetime Learning Credit	(\$61)	(\$53)	(\$55)
Deduction of Interest	(\$14)	(\$15)	(\$16)
<u>Total</u>	(\$93)	(\$82)	(\$85)

The provisions relating to the Scholarshare program would not change baseline revenue projections since the proposal addresses modifications and clarifications that were considered in the revenue estimates of AB530 (Stats. 1997, Ch. 851).

This analysis does not consider the possible changes in employment, personal income, or gross state product that could result from this proposal.

Tax Revenue Discussion

HOPE and Lifetime Learning Credits

These estimates were derived from information from the California Postsecondary Education Commission on student profiles and costs, combined with state tax return data on income and tax liability distributions. For 1998 it is projected that approximately 1,065,000 taxpayers (138,000 taxpayers claiming the Hope credit and 928,000 claiming the Lifetime Learning credit) would claim education credits.

Deduction for Interest on Education Loans

These estimates were derived from information from the California Aid Commission Office on students loans. The vast majority of taxpayers would be former students (rather than parents) with modest incomes. It was projected that of the approximately 1 million students in repayment status, half (500,000) would claim the interest deduction for tax year 1998. Many would not be eligible due to the interest period limitation (first 60 months of payments), AGI tests, home equity financing of loans for which interest

is currently deductible, and defaults on loans. It was assumed that the average annual interest payment would be \$600 (one-half of an average annual payment of \$1,200). If a marginal tax rate of 4.5% is applied to these deductions, the impact would be around \$14 million.

BOARD POSITION

Pending.