Franchise Tax Board

ANALYSIS OF ORIGINAL BILL

Author: Poochigian | Analyst: Kristina E. North | Bill Number: SB 1369

Related Bills: None | Telephone: 845-6978 | Introduced Date: January 19, 2000

Attorney: Patrick Kusiak | Sponsor:

SUBJECT: Student Eligible Fees Credit/FTB Reports to Department of Finance and Legislature

SUMMARY

Under the Personal Income Tax Law (PITL) and the Bank and Corporation Tax Law (B&CTL), this bill would allow a credit equal to 100% of eligible fees paid by a taxpayer on behalf of any student who is a resident of this state.

This bill also would mandate that state revenues supporting the public school system and public institutions of higher learning would not be reduced below the amount that would have been required for that support if the credits provided by this bill had not been authorized. This provision will not be discussed in this analysis as it does not impact the department's programs and operations.

EFFECTIVE DATE

This bill would apply to taxable and income years beginning on or after January 1, 2000.

SPECIFIC FINDINGS

Current state and federal laws do not allow a tax deduction for personal expenses (such as a kindergarten through 12th grade child's educational expenses), except where specifically authorized. Alimony paid is deductible as an adjustment to income. Medical expenses, charitable contributions, interest, and taxes are deductible as itemized deductions. Expenses for the production of income and certain employee business expenses are considered miscellaneous itemized deductions and must exceed 2% of adjusted gross income (AGI) to be deducted.

Current federal and state laws allow a deduction for contributions to various types of qualified organizations, including organizations formed for educational purposes such as public schools. However, taxpayers cannot designate a specific student to receive the benefit of the charitable contribution.

Current federal and state laws provide for various tax credits designed to provide tax relief for taxpayers who must incur expenses or to influence business practices and decisions. However, federal and state laws do not currently allow a credit for educational expenses relating to the schooling of a taxpayer's child in grades K-12.

Current federal law allows two credits related to students pursuing college or graduate degrees or vocational training. The Hope Scholarship Credit provides a credit for 100% of qualified tuition and related expenses, for a maximum allowable credit of $1,500 per student for each of the first two years of post-secondary education.

Board Position:			Department Director	Date
____ S	____ NA	____ NP	Gerald H. Goldberg	3/7/00
____ SA	____ O	____ NAR		
____ N	____ OUA	__X__ PENDING		

The Lifetime Learning Credit allows a credit of 20% of qualified tuition and related expenses (up to $5,000 for taxable years beginning before January 1, 2003, and $10,000, thereafter) paid by the taxpayer for any year the Hope Scholarship Credit is not claimed. State law does not currently allow a credit for educational expenses.

Current state law provides general rules which apply to all tax credits, unless the individual credit provisions specify otherwise. General rules describe the division of credits among multiple taxpayers or between a husband and wife. Except as specified, no tax credit may reduce regular tax below the tentative minimum tax for alternative minimum tax purposes.

This bill would allow a credit equal to 100% of eligible fees paid or incurred during the taxable or income year by any taxpayer on behalf of any student who is a resident of this state.

This bill would define eligible fees as fees paid for the administration of advanced placement examinations conducted by the College Entrance Examination Board (on the basis of which participating institutions of post-secondary education award post-secondary academic credit); Scholastic Aptitude Test application fees; University of California application fees; California State University application fees; and California private university application fees.

This bill would require the taxpayer to provide to the Franchise Tax Board (FTB), upon request, a copy of the receipt for the costs of any eligible fees paid.

This bill would specify Legislative intent that the credit may be accrued for more than one student and more than one examination.

This bill would require the FTB to report to the Department of Finance (DOF) by January 1 of each year the amount of credits claimed in the taxable and income years ending in the preceding calendar year. In addition, **this bill** requires the FTB to report to the Legislature on or before July 2001, the fiscal impact of the credits allowed by this bill.

This bill would provide that the credit would be divided equally between a husband and wife filing separate returns.

This bill would provide that the credit be in lieu of any deduction the taxpayer would otherwise be entitled to claim for the contribution.

This bill would provide that a taxpayer may carry over any excess credit for the succeeding five years or until exhausted, whichever occurs first.

Constitutional Consideration

This bill would limit the credit to the amount paid for eligible fees on behalf of any student who is a resident of California. However, the amount of the fees are not based on residence of the student. In fact, the fees are the same for residents and nonresidents. This residency requirement may be subject to constitutional challenge as indirectly discriminatory against non-resident students who wish to attend California schools by virtue of the credit being available only to taxpayers who pay eligible fees on behalf of students who are residents, rather than to all students who attend school within California.

Policy Considerations

This bill would allow a credit equal to 100% of identified costs. A credit equal to 100% of an expenditure, without limitation.

Most credits contain a sunset date so that the Legislature may review the effectiveness of the credit. This bill does not contain a sunset date.

This bill would require a married couple filing separately to divide the credit equally. The author may wish to delete the language regarding division of the credit and allow the general rule to prevail. This would allow the couple to have the flexibility to divide the credit or allow one spouse to claim the entire amount to maximize current utilization of the credit.

Implementation Considerations

A definition for "student" would be helpful to clarify on behalf of whom the author wishes the expenses to apply. It is unclear if "student" would include an applicant who is not a registered in school at the time of payment of the application fees.

This bill requires the FTB to report to the DOF by January 1 of each year the amount of credits taken in the taxable and income years ending in the previous calendar year. For taxpayers reporting on a calendar year, the required report would be due to DOF the day after the taxable or income year ended and before the credits were claimed. Tax returns for individuals are typically due on April 15 with an automatic extension to October 15, while the due date for businesses depends on their fiscal year. Information regarding credits claimed for a tax/income year is typically not available until approximately July 1 in the year following the filing year. For example, information regarding the 1999 taxable/income year will be available July 1, 2001. The department would be unable to provide the information at the time specified.

Similarly, the information would not be available for the report to the Legislature due in July 2001 for taxable/income year 2000. Clarification is needed to determine if the author intended that an employer could elect to pay these expenses "on behalf of" a student who could be either an employee or dependent of an employee. If this were the case, then perhaps the employer might try to treat the payment as either additional deductible compensation. If the first technical consideration below is resolved to clearly disallow a deduction for any portion of eligible fees for which this credit is allowed, this implementation consideration would be eliminated.

Department staff is available to assist in resolving these and any other issues that may be identified.

Technical Considerations

This bill does not provide a credit for a "contribution." Thus, the language disallowing a deduction for any portion of the "contribution" could have no effect. The author may wish to clarify this language.

The language regarding division of the credit between a husband and wife should be deleted from the B&CTL since individuals file under the PITL.

LEGISLATIVELY MANDATED REPORTS

The FTB would be required to report to the DOF by January 1 of each year the amount of credits claimed under this bill for the taxable and income years ending in the preceding calendar year.

The FTB would be required to report to the Legislature on or before July 2001, the fiscal impact of the credits provided by this bill.

FISCAL IMPACT

Departmental Costs

When the implementation issues are resolved, this bill would not significantly impact the department's costs.

Tax Revenue Estimate

This bill is estimated to result in revenue losses as shown in the following table.

Fiscal Year Cash Flow Taxable Years Beginning After December 31, 1999 Enactment Assumed After June 30, 2000 $ Millions		
2000/2001	2001/2002	2002/2003
-$50	-$53	-$56

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

Tax Revenue Discussion

The revenue impact for this bill will be determined by the number of applications filed, the cost eligible fees, and the amount of credits that can be applied against available tax liabilities.

This estimate was developed using the following steps:

1)According to the California State University (CSU), Chancellor’s Office, approximately 365,076 applications were filed in 1998, with an average application fee of $55.
The number of applications was grown 5% per year, yielding 402,496 applications for 2000. The resulting number was adjusted downward by 10% to take into account applications filed from out of state and waivers allowed, yielding approximately 362,247 qualifying applications for CSU Colleges for tax year 2000 or $20 million in tax credits.

2) According to the University of California, Office of the President (UCOP), approximately 221,921 applications were filed by California residents in 1998. This number was grown 5% per year, yielding approximately 243,973 applications for 2000, with an average application fee of $40. The application number was adjusted downward by 15% to reflect waivers allowed by the universities, yielding approximately 207,377 qualifying applications for tax year 2000 or $8.3 million in tax credits.

3) According to the Private/Independent Colleges, approximately 90,000 applications were filed for 1999. This number was grown 5% per year, yielding approximately 94,500 applications for 2000, with an average application fee of $41. According to the same source, approximately 25% of all applications filed for private universities are either waived or filed from out of state, leaving approximately 70,875 qualifying applications for tax year 2000 or $2.9 million in tax credits.

4) According to the College Board in Sacramento, approximately 151,636 applications were filed for the Scholastic Aptitude Test I (SAT I) and 68,054 for the SAT II for 1999, with an average fee of $24 (SAT I) and $21 (SAT II). These numbers were grown 5% per year yielding approximately 159,218 for SAT I and 71,457 for SAT II for 2000. These numbers were further adjusted downward 10% to reflect waivers allowed for lower income families, yielding approximately 143,296 qualifying applications for the SAT I and 64,311 for the SAT II for a total of $4.7 million in tax credits for tax year 2000.

5) According to the same source, approximately 203,523 Advance Placement Test were given in 1999, with an average fee of $76. This number was grown 5% per year, yielding approximately 213,699 test for 2000. This number was further adjusted downward by 10% to reflect waivers allowed for lower income families, yielding approximately 192,329 qualifying applications for tax year 2000 or $14.6 million in tax credits.

The total proposed revenue loss from this bill is approximately $50 million for tax year 2000. It was assumed that 75% of allowed credits would be applied in any given year and the balance, due to insufficient tax liabilities, would be carried over and applied in the following year. Revenue losses were adjusted to account for current law deductions available to employers. Losses were grown 5% to account for growth and incentive effects.

BOARD POSITION

Pending.