Franchise Tax Board

SUMMARY ANALYSIS OF AMENDED BILL

Author:	Bonilla	Analyst:	Jane Raboy	Bill Number:	AB 17
Related Bills:	See Prior Analysis	Telephone:	845-5718	Amended Date:	April 21, 2015
		Attorney:	Bruce Langston	Sponsor	

SUBJECT:	Contributions to Qualified Tuition Program Account Refundable Credit

SUMMARY

This bill would create a refundable credit for contributions to a qualified tuition program under the Personal Income Tax Law.

RECOMMENDATION

No position.

SUMMARY OF AMENDMENTS

The April 21, 2015, amendments resolved the technical concerns and several, but not all, of the implementation concerns discussed in the department's analysis of the bill as introduced on December 1, 2014. As a result of the amendments, the "This Bill," "Implementation Considerations," and "Economic Impact" sections have been revised. Additionally, the "Economic Impact"[1] and the "Support/Opposition" sections incorporate updated information now available to the department.

The remainder of the department's analysis of the bill as introduced on December 1, 2014, still applies. The "Fiscal Impact" and "Policy Concerns" sections have been restated for convenience.

THIS BILL

For each taxable year beginning on or after January 1, 2016, and before January 1, 2021, this bill would allow a credit equal to the lesser of 20 percent of the monetary contributions made by a qualified taxpayer to one or more qualified tuition programs during the taxable year; or $500.

This bill would define the following phrases:

- “Qualified taxpayer” means an individual who, on behalf of a beneficiary, contributes money to a qualified tuition program and has one of the following annual adjusted gross incomes:
  - ➢ In the case of a single individual or married individual filing a separate return, $100,000 or less.
  - ➢ In the case of a head of household or surviving spouse, as defined in Section 17046, or a married couple filing a joint return, $200,000 or less.

[1] The "Economic Impact" section is mainly updated to incorporate the survey information from the Hart Research Associates.

Board Position:						Legislative Director	Date
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- "Qualified tuition program" means a qualified tuition program, as defined in IRC Section 529.

An additional tax would be imposed on a qualified taxpayer who receives a nonqualified withdrawal in an amount that is the lesser of:

- 10 percent of that nonqualified withdrawal, or
- The total credit amount allowed for the current taxable year and all prior taxable years that the qualified taxpayer was allowed a credit.

"Nonqualified withdrawal" means any payment or distribution from a qualified tuition program that is subject to additional tax pursuant to IRC Section 529(c)(6), relating to additional tax.[2]

Upon an appropriation by the Legislature, the portion of any credit allowed that is in excess of tax liability, would be credited against other amounts due, if any, and the balance, if any, required to be refunded to the qualified taxpayer.

This bill would authorize the Franchise Tax Board (FTB) to prescribe rules, guidelines, or procedures necessary or appropriate to administer the credit.

Any standard, criterion, procedure, determination, rule, notice, or guidelines established or issued by the FTB would be exempt from the Administrative Procedures Act.[3]

This credit would remain in effect only until December 1, 2021, and would be repealed as of that date.

IMPLEMENTATION CONSIDERATIONS

The department has identified the following implementation concerns. Department staff is available to work with the author's office to resolve these and other concerns that may be identified.

This bill would require regular annual appropriations by the Legislature to pay for the refundable portion of this credit. If insufficient funds are appropriated to cover all of the refunds due, the department would suspend payment of refunds until additional funds were appropriated. Interest would accrue during the suspension period. Suspension of refunds could result in additional contacts to the department that may increase departmental costs.

With the exception of contributions to the California ScholarShare program, it is unclear how the department could verify that the contributions were made to an out-of-state qualified tuition program.

[2] If a distribution is not used to pay qualified higher education expenses, the distribution is included in gross income. The income tax is increased by 10 percent of the amount of earnings which are so included, unless otherwise specified.

[3] Chapter 3.5 (commencing with Section 11340) of Part 1 of Division 3 of Title 2 of the Government Code.

FISCAL IMPACT

The FTB does not currently administer a refundable tax credit. Establishing a refundable tax credit program would have a significant impact on the department's programs and operations and require extensive changes to forms and systems. As the bill continues to move through the legislative process and the implementation concerns are resolved, costs will be identified and an appropriation will be requested, if necessary.

ECONOMIC IMPACT

Revenue Estimate

Estimated Revenue Impact of AB 17 As Amended on April 21, 2015 Assumed Enactment After June 30, 2015 ($ in Millions)		
2015-16	2016-17	2017-18
- $44	- $80	- $95

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

Revenue Discussion

This bill allows a qualified taxpayer to file for a refundable tax credit based on contributions to a Section 529 Plan. Once fully implemented, the revenue loss is estimated at $95 million per year.

The Investment Company Institute (ICI), reports there were 11.9 million open Section 529 Plan accounts nationwide as of June 2014. If the percentage of these accounts held by Californians is proportional to California's share of the population (about 12 percent), California residents have approximately 1.4 million accounts. In addition, California nonresidents have an additional 85,000 accounts, bringing the total accounts to 1.5 million. Scholarshare data reports approximately 1.65 accounts per account owner, which would imply that approximately 920,000 California taxpayers have Section 529 accounts.

Using 2012 Federal adjusted gross income (AGI) data, approximately 70 percent or 611,000 of the estimated California resident owners meet the income requirements specified in the bill. After applying the 4.5 percent average annual historical growth rate to the 2014 and 2015 account volumes, there would be an estimated 667,000 qualified taxpayers in 2016.

There is some survey evidence (such as by Hart Research Associates) suggesting that the proportion of Californians with Section 529 accounts is below the national average. The incentives in this proposal should increase participation, bringing California's proportion closer to the national average. This estimate assumes that after implementation, participation in California would be about 10 percent below the national average, therefore, approximately 600,000 California taxpayers would qualify for this credit.

Based on TIAA-CREF Financial Services data, approximately 50 percent of account holders make regular annual contributions. This percentage rises to 58 percent in states with deductions or nonrefundable tax credits for contributions. Because the credit in this proposal is refundable, the estimate assumes an even higher level of regular contributions, 70 percent, or 420,000, for 2016.

It was assumed single taxpayers with AGI less than $25,000 and married filing joint taxpayers with AGI less than $40,000 would not contribute to a Section 529 Plan. For taxpayers with AGI higher than $25,000 or $40,000, depending on the filing status, it was assumed contribution amounts would increase relative to the increase in AGI. After multiplying the assumed contribution amount by the number of taxpayers in each assumed contribution tier, it is estimated that qualified contributions would be $478 million in taxable year 2016.

The total estimated contribution per taxable year, based on the lesser of 20 percent of qualified contributions or $500, was multiplied by 20 percent, arriving at a potential tax credit of $86 million in taxable year 2016.

The estimate assumes 80 percent of eligible taxpayers would take advantage of the credit in the first year and 100 percent thereafter. The taxable year estimates were reduced by one percent for taxpayers taking nonqualified withdrawals for taxable year 2016. The total credit for resident taxpayers was offset by the additional tax amount to calculate the total credit per taxable year, or $69 million for taxable year 2016.

The revenue impact for nonresident taxpayers was estimated using the same methodology as for resident taxpayers. Additionally, because Revenue and Taxation Code section 17055 requires the credit for nonresidents and part-year residents be limited to the "credit percentage" (the ratio of California taxable income to total taxable income), an 81.6 percent reduction was made (based on analysis of taxable year 2012 data), arriving at an estimated credit of $610 thousand in taxable year 2016.

The combined results for the resident and nonresident taxpayers were then converted to fiscal years and rounded.

SUPPORT/OPPOSITION[4]

Support: California Association of Private School Organizations, California Catholic Charities, California Communities United Institute, Contra Costa County Office of Education, Early Edge California, Financial Services Institute, Greenlining Institute, National Association of Insurance and Financial Advisors – California, Parent Institute for Quality Education, Pleasanton Unified School District, President, John F. Kennedy University, Securities Industry and Financial Markets Association, State Farm Mutual Automobile Insurance Company's, United Way California Capital Region, and Urban League of San Diego County

Opposition: California Tax Reform Association.

[4] As noted in the Assembly Committee on Revenue and Taxation bill analysis dated April 10, 2015.

POLICY CONCERNS

This refundable credit would be available to a qualified taxpayer with California source income regardless of the location of the qualified taxpayer, the qualified tuition program, the beneficiary, or where the beneficiary's qualified higher education expenses were paid or incurred. If this eligibility is broader than the author intends, this bill should be amended.

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