Franchise Tax Board

ANALYSIS OF ORIGINAL BILL

Author:	Lackey & Olsen	Analyst:	Davi Milam	Bill Number:	AB 1371
Related Bills:	See Legislative History	Telephone:	845-2551	Introduced Date:	February 27, 2015
		Attorney:	Bruce Langston	Sponsor	

SUBJECT:	Education-Related Expenses Deduction

SUMMARY

This bill would, under the Personal Income Tax Law, allow a deduction from gross income for certain education-related expenses.

RECOMMENDATION

No position.

REASON FOR THE BILL

The reason for this bill is to ease the financial burden on low and middle-income parents of providing a high-quality K-12 education.

EFFECTIVE/OPERATIVE DATE

As a tax levy, this bill would be effective immediately upon enactment and specifically operative for taxable years beginning on or after January 1, 2016, and before January 1, 2021.

FEDERAL/STATE LAW

Existing federal and state laws provide that gross income includes all income from whatever source derived, including compensation for services, business income, gains from property, interest, dividends, rents, and royalties, unless specifically excluded.

Existing federal and state laws allow for the deduction of certain expenses, from gross income, when calculating adjusted gross income (AGI), such as moving expenses and interest on education loans, certain ordinary and necessary trade and business expenses, losses from the sale or exchange of certain property, contributions for pension, profit-sharing and annuity plans of self employed individuals, retirement savings, and alimony. Thus, all taxpayers with these types of expenses receive the benefit of the deduction, regardless of whether the taxpayer itemizes deductions or uses the standard deduction. These are known as “above-the-line” deductions.

There are currently no federal or state deductions from gross income comparable to the deduction that this bill would create.

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THIS BILL

For each taxable year beginning on or after January 1, 2016, and before January 1, 2021, this bill would allow a deduction in an amount equal to the qualified amount that was paid or incurred for qualified education-related expenses for one or more dependent children by a qualified taxpayer during the taxable year, not to exceed $2,500 in a taxable year. If a deduction is allowed to more than one qualified taxpayer for expenses related to a dependent child, the total combined deduction amount allowed under this bill cannot exceed $2,500 in a taxable year.

This bill would allow the deduction for education-related expenses to be taken as an "above-the-line" deduction when calculating AGI.

This bill would define the following terms and phrases:

- "Dependent children" means children who attend kindergarten or any of grades 1 to 12, inclusive, in California at a public, charter, or private school that has a current private school affidavit on file with the State Department of Education in the taxable year and who meet the requirements of Section 152(c)(1)(D) and (E) of the Internal Revenue Code (IRC).[1]
- "Qualified amount" means the amount paid or incurred for qualified education-related expenses, not to exceed $2,500.
- "Qualified education-related expenses" means the kindergarten or any of grades 1 to 12, inclusive, costs of: textbooks and school supplies, including, but not limited to, pens, paper, pencils, notebooks, calculators, and rulers; the rental or purchase of educational equipment required for classes during the regular school day; school uniforms that are not part of a cocurricular activity; computers, computer hardware, and educational computer software used to learn academic subjects; fees for college courses at public institutions or independent nonprofit colleges, or for summer school courses that satisfy high school graduation requirements; psychoeducational diagnostic evaluations to assess the cognitive and academic abilities of pupils; special education and related services for pupils who have an individualized education program or its equivalent; out-of-school enrichment programs, tutoring, and summer programs that are academic in nature; and public transportation or third-party transportation expenses for traveling directly to and from school.

  Expenses for items that are used in a trade or business would be specifically excluded from the definition of "qualified education-related expenses."

[1] The term qualifying child under this section means, an individual, who hasn't provided over one-half of his or her own support for the calendar year, and who must be younger than the claimant and be unmarried; qualifying child benefits restricted to child's parents.

- "Qualified taxpayer" means a parent or legal guardian of a full-time pupil who is under 21 years of age at the close of the school year who meets both of the following requirements:
    - Both the pupil and the parent or guardian reside in California when the qualified education-related expenses are paid or incurred; and
    - The household income does not exceed 250 percent of the federal Income Eligibility Guidelines published by the Food and Nutrition Service of the United States Department of Agriculture for use in determining eligibility for reduced price meals.
- "Household income" means gross income defined in Section 61 of the IRC.[2]

The Franchise Tax Board (FTB) would have the authority to prescribe rules, guidelines or procedures necessary or appropriate to carry out the provisions of the bill. These rules, guidelines, or procedures would be exempt from the normal rulemaking requirements of the Administrative Procedures Act.

This provision would be repealed by its own terms as of December 1, 2021.

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.

In the definition of a "qualified taxpayer," household income would mean gross income as defined by the IRC. Gross income is not a figure that appears on federal or state tax returns. To avoid confusion and for ease of administration, the author may want to consider replacing the reference to gross income with a reference to AGI.

This bill provides that if a deduction is allowed to more than one qualified taxpayer for the same dependent child, the total combined deduction amount allowed under this bill cannot exceed $2,500 per taxable year. It is unlikely that the parents or guardians would be aware of the other's qualified expenses, and when the returns are being processed the department would be unable to determine if the taxpayers had exceeded the total combined limit of the deduction amount. To avoid conflicts between taxpayers and the department, the author may wish to consider allowing the deduction to the taxpayer that can claim the "dependent child" as a dependent on their tax return.

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[2] Gross income under this section means all income from whatever source derived, including (but not limited to) compensation for services, business income, gains from property, interest, dividends, rents, and royalties, unless specifically excluded.

Additionally the defined phrase “dependent child”, and the undefined term "pupil" and phrase “full-time pupil” are used inconsistently. It is recommended that the bill be amended for consistency of terminology and to clarify the relationship between the taxpayer and the individuals that could generate a deduction to clearly express the author's intent and prevent conflicts between taxpayers and the department.

This bill would allow a deduction to a qualified taxpayer that pays for or incurs qualified education-related expenses for one of more dependent children, as defined. Because “qualified taxpayer” on a jointly field return could be either one or two individuals, the maximum deduction on a jointly filed return could be $5,000. If this is contrary to the author’s intent this bill should be amended.

TECHNICAL CONSIDERATIONS

To clearly identify “Household income” as a defined term on page 3, line 22, it is recommended that quotation marks (““) be inserted around the term “Household income.”

LEGISLATIVE HISTORY

AB 1786 (Olsen, 2013/2014) would have allowed a deduction from gross income for certain education-related expenses. AB 1786 failed to pass by the constitutional deadline.

AB 819 (Runner, 2007/2008) and SB 643 (Florez, 2007/2008) would have allowed a deduction for contributions made by a qualified taxpayer to certain qualified tuition programs. AB 819 and SB 643 both failed to pass by the constitutional deadline.

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. Except for *Minnesota*, no deduction comparable to the deduction proposed by this bill was identified.

Minnesota allows a subtraction from taxable income for certain education-related expenses for a qualifying child in kindergarten through grade 12 (K-12). The maximum subtraction that can be claimed is $1,625 per qualifying child in grades K through 6 and $2,500 for a qualifying child in grades 7 through 12.

FISCAL IMPACT

Department costs have yet to be determined at this time. 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

This bill would result in the following revenue loss:

Estimated Revenue Impact of AB 1371 As Introduced February 27, 2015 Assumed Enactment After June 30, 2015 ($ in Millions)		
2016-17	2017-18	2018-19
- $26	- $27	- $28

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

Revenue Discussion:

Data from taxable year 2011 returns filed with the FTB show that approximately 1.2 million taxpayers met the income eligibility provisions specified in the bill. It is assumed that 100 percent of all qualified taxpayers would take the deduction. The Bureau of Labor and Statistics indicates that qualified taxpayers spend nearly $700 annually on qualified education related expenses for a total estimated deduction of approximately $850 million. Using an average tax rate of 2.5 percent for qualified taxpayers, the annual tax loss would be approximately $20 million.

This amount is grown based on Department of Finance personal income tax growth rates, rounded, and converted to the fiscal estimates reflected in the table above.

SUPPORT/OPPOSITION

Support: None provided.

Opposition: None provided.

ARGUMENTS

Proponents: Some may say that this bill would provide needed financial assistance to parents who reach into their own pockets to fund vital education resources and services.

Opponents: Some may say that providing a tax incentive for parents to assist with expenses associated with educating the state’s children will result in revenue losses, which have to be paid for with higher taxes on others or reductions in services.

POLICY CONCERNS

This bill would create differences between federal and California tax law, thereby increasing the complexity of California tax return preparation. Tax credits, rather than deductions, are claimed after taxable income has been calculated and, therefore, do not create differences between the taxable income amounts shown on the federal and state income tax returns.

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