

ANALYSIS OF ORIGINAL BILL

Author: Patterson, et al. Analyst: Jane Raboy Bill Number: AB 209
 See Legislative History
 Related Bills: History Telephone: 845-5718 Introduced Date: February 2, 2015
 Attorney: Bruce Langston Sponsor _____

SUBJECT:	Qualified Tuition Program Deduction/529 College Savings Plans
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SUMMARY

This bill would allow a deduction under the Personal Income Tax Law for the amounts contributed by a qualified taxpayer to a qualified tuition program.

RECOMMENDATION

No position.

REASON FOR THE BILL

The reason for the bill is to encourage families or parents to save for a college education.

EFFECTIVE/OPERATIVE DATE

As a tax levy, this bill would be effective upon enactment and operative for taxable years beginning on or after January 1, 2015.

FEDERAL/STATE LAW

Existing federal and state laws allow individuals to deduct certain expenses, such as medical expenses, charitable contributions, interest, and taxes, as itemized deductions. Certain other expenses for the production of income and certain employee business expenses are considered miscellaneous itemized deductions and the portion that exceeds 2 percent of adjusted gross income (AGI) may be deducted. Also, itemized deductions may be further limited for high-income taxpayers.

Federal Law

Internal Revenue Code (IRC) Section 529 (Section 529 Plan) provides tax-exempt status to qualified tuition programs.

Contributions to a qualified tuition program must be made in cash. The Section 529 Plan does not impose a specific dollar limit on the amount of contributions, account balances, or prepaid tuition benefits relating to a qualified tuition account; however, the program is required to have adequate safeguards to prevent contributions in excess of amounts necessary to provide for the beneficiary's qualified higher education expenses. Contributions are not tax deductible for federal income tax purposes, but amounts earned in the account (i.e. interest) accumulate on a tax-free basis.

Board Position:	Executive Officer	Date									
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Distributions from a qualified tuition program are excludable from federal tax if used for the beneficiary's qualified higher education expenses. If a distribution from a qualified tuition program exceeds the qualified higher education expenses incurred for the beneficiary, the portion of the excess that is treated as earnings generally is subject to income tax and an additional 10-percent tax. Amounts in a qualified tuition program may be rolled over to another qualified tuition program for the same beneficiary or for a member of the family of that beneficiary.

State Law

California conforms, with modifications, to Section 529 Plans as of the "specified date" of January 1, 2009, as they relate to tax-exempt qualified tuition programs. California modifies the additional 10-percent tax on excess distributions to instead be an additional tax of 2.5 percent for state purposes.

Similar to federal law, state law provides that contributions made to a qualified tuition program are not deductible.

THIS BILL

This bill would allow a qualified taxpayer a personal income tax deduction equal to the lesser of the following:

- The amount contributed during the taxable year to a qualified tuition program¹ not to exceed the following amounts:
 - \$ 3,000 for single or a married individual filing a separate return.
 - \$ 6,000 for married individual filing a joint return or an individual filing a head of household return.

The deduction would be allowed as an itemized deduction not subject to the 2-percent floor of AGI floor that generally applies to miscellaneous itemized deductions.

"Qualified taxpayer" would mean an individual who, on behalf of a beneficiary, contributes money to a qualified tuition program and meets all of the other applicable requirements.²

The deduction would be required to be taken in the taxable year that the contribution is made.

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.

¹ IRC Section 529, as modified by Revenue and Taxation Code section 17140.3.

² Ibid.

This bill would allow a qualified taxpayer to make a contribution to a Section 529 plan, and generate a deduction even if the funds are immediately withdrawn. Additionally, the deduction would be allowed even if the withdrawal was nonqualifying. If this is contrary to the author's intent, the author may wish to amend the bill to provide a recapture or disallowance provision.

This bill is silent on (1) whether amounts transferred or rolled over from another state's Section 529 Plan would qualify for the deduction and (2) how the department could verify that a contribution was made to a qualified tuition program. The lack of guidance could cause disputes between taxpayers and the department and require the department to open up an audit in order to verify the amount of contributions made by taxpayers.

TECHNICAL CONSIDERATIONS

The bill contains incorrectly referenced provisions. Subdivision (b) should be used for definitional terms and subdivision (b)(1) should read subdivision (c).

Subdivision (c) specifying that the deduction be taken in the taxable year that the contribution is made is unnecessary because existing state law provides this general rule.

LEGISLATIVE HISTORY

AB 675 (Gilmore, 2009/2010) was substantially similar to this bill and would have allowed a deduction for contributions made to a qualified tuition program. AB 675 failed passage out of the Assembly by the constitutional deadline.

AB 819 (Runner, 2007/2008) and SB 643 (Florez, 2007/2008) were similar to this bill and would have allowed a deduction for contributions made by a qualified taxpayer to certain qualified tuition programs. AB 819 failed passage out of the Assembly by the constitutional deadline and SB 643 failed passage out of the Senate 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. A review of these states' laws found the following:

Florida does not impose an individual income tax, so a comparison to *Florida* is not relevant.

Illinois conforms to IRC section 529, and has three qualified tuition programs: the College Illinois Prepaid Tuition Plan, the Bright Start College Savings Plan, and the Bright Directions College Savings Program. *Illinois* allows a deduction of up to \$10,000 per taxable year for single filers and up to \$20,000 per year for joint filers (per beneficiary) for contributions to its qualified tuition programs.

Massachusetts conforms with the federal treatment of qualified tuition programs under IRC section 529, and has its own qualified tuition program, the U Plan Prepaid Tuition Program. *Massachusetts* lacks a deduction for contributions to its qualified tuition program.

Michigan conforms to IRC section 529, and allows deductions of up to \$5,000 per taxable year for single filers and \$10,000 per taxable year for joint filers for contributions to its qualified tuition program, the Michigan Education Savings Program.

Minnesota conforms to IRC section 529, and has one qualified tuition program, the Minnesota College Savings Plan. *Minnesota* lacks a deduction for contributions to its qualified tuition program.

New York conforms to the federal treatment of qualified tuition programs under IRC section 529, and has one qualified tuition program, the New York State College Choice Tuition Savings Program. *New York* allows a deduction of up to \$10,000 per taxable year for single filers and up to \$20,000 per year for joint filers for contributions to its qualified tuition program.

FISCAL IMPACT

Department staff is unable to determine the costs to administer this bill until the implementation concerns have been resolved. 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 209 As Introduced February 2, 2015 Assumed Enactment After June 30, 2015 (\$ in Millions)		
2015-16	2016-17	2017-18
- \$310	- \$200	- \$210

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 would allow a qualified taxpayer to deduct contributions, in the taxable year made, to their Section 529 Plan as an itemized deduction not subject to the 2 percent floor. The allowable deduction is the lesser of the actual amount contributed, or \$3,000 for single or married filing separate taxpayers and \$6,000 for married or head of household taxpayers.

The Investment Company Institute 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. California nonresidents have an additional 85,000 accounts bringing the total to approximately 1.5 million accounts. After applying the 4.5 percent average annual historical growth rate to the 2014 and 2015 account volumes, the number of accounts in 2016 is estimated at approximately 1.7 million (residents – 1.6 million; nonresidents – 92,000).

A survey by Hart Research Associates³ suggests that the proportion of Californians with Section 529 accounts is below the national average. The incentives in this bill should increase participation, bringing California's proportion closer to the national average. This estimate assumes that after implementation, participation in California would be approximately 10 percent below the national average.

Generally, contributors to Section 529 Plans are made by higher income taxpayers that would contribute the maximum of \$3,000 or \$6,000 depending on their filing status. Based on several variables, it was estimated that the total contributions eligible for the deduction would be \$2.1 billion in 2016. Variables considered included, but were not limited to, the impact on itemized deductions and the associated limitations, and taxpayers with more than one Section 529 account. A high earner marginal tax rate of approximately 10 percent was applied resulting in a \$200 million revenue loss for taxable year 2016.

The estimates are converted to the fiscal year estimates, then rounded, in the table above.

SUPPORT/OPPOSITION

Support: None provided.

Opposition: None provided.

ARGUMENTS

Proponents: Those in support of this bill may argue that it would provide much-needed tax relief to families who are ineligible for financial aid and lack the resources to pay.

Opponents: Those who oppose this bill may argue that its proposed contribution deduction should be expanded to be available to taxpayers who claim the standard deduction instead of limiting the proposed deduction to taxpayers who itemize deductions.

POLICY CONCERNS

This bill would limit the proposed deduction to taxpayers who itemize deductions. A taxpayer who claims the standard deduction would be unable to take this deduction.

³ Key Findings From 2013 California ScholarShare College Savings Survey by Mark Bunge, Hart Research Associates, September 17, 2013.

This bill would establish a deduction for which federal law has no counterpart, thus increasing nonconformity.

LEGISLATIVE STAFF CONTACT

Jane Raboy
Legislative Analyst, FTB
(916) 845-5718
jane.raboy@ftb.ca.gov

Jame Eiserman
Revenue Manager, FTB
(916) 845-7484
jame.eiserman@ftb.ca.gov

Gail Hall
Legislative Director, FTB
(916) 845-6333
gail.hall@ftb.ca.gov