



## **Analysis of Amended Bill**

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**Subject:** Golden State Credit

### **Summary**

This bill would, under newly-created Part 10.4 of the Revenue and Taxation Code (R&TC), allow a tax credit for the transfer of a Golden State Credit (GSC) under the Personal Income Tax Law and the Corporation Tax Law.

**Recommendation – No position.**

### **Summary of Amendments**

The May 2, 2018, amendments renamed the credit program and recast the provisions of the newly created GSC. As a result of the amendments, the department's analyses of the bill as introduced March 30, 2018, and amended April 5, 2018, no longer apply.

This analysis only addresses the provisions of the bill that impact the department's programs and operations.

### **Reason for the Bill**

The reason for the bill is to assist certain exempt organizations and educational institutions to supplement their income.

### **Effective/Operative Date**

As a tax levy, this bill would be effective immediately upon enactment and specifically operative for each taxable year beginning on or after January 1, 2019, and before January 1, 2024.

### **Federal/State Law**

Existing federal and state laws provide various tax credits designed to provide tax relief for taxpayers who incur certain expenses (e.g., child adoption) or to influence behavior, including business practices and decisions (e.g., research credits or economic development area hiring credits). These credits generally are designed to provide incentives for taxpayers to perform various actions or activities that they may not otherwise undertake.

Existing federal and state laws allow a deduction from income for charitable contributions. Under certain circumstances, an individual is allowed to deduct the fair market value of the property being contributed. An individual can deduct an amount not to exceed a specified percent of federal adjusted gross income, depending on the type of property given and the type of charitable organization. The charitable contribution deduction for a corporation is limited to the adjusted basis of the property being contributed. In addition, the amount a corporation can deduct for a charitable contribution in a given year is limited to 10 percent of the corporation's net income. A contribution made by either an individual or a business in excess of the percentage limitations may be carried over and deducted in future years. If a donor receives a benefit for making the contribution, the deduction may be denied or limited by the amount of any benefit received.

Under R&TC section 41, legislation that would create a new tax credit is required to include specific goals, purposes, objectives, and performance measures to allow the Legislature to evaluate the credit's effectiveness.

### **This Bill**

This bill would enact the Bridget "Biddy" Mason GSC Program. Under the terms of that program, the bill would allow, beginning on and after January 1, 2019, and before January 1, 2024, a qualified entity to transfer monetary amounts to the State Treasurer in order to receive GSCs at a rate of ninety cents (\$0.90) per GSC. The bill would define the following terms:

- "GSC" to mean a Golden State Credit.
- "Qualified entity" to mean:
  - An organization exempt from federal income taxation as an organization described in Section 501(c)(3) of the Internal Revenue Code (IRC) that is in active status as listed on the Secretary of State's Internet Web site,
  - A postsecondary educational institution that participates in the Cal Grant program,
  - A community college located in the state, or
  - A K–12 public school district located in the state.

The bill specifically excludes a private foundation, as defined in Section 509 of the IRC from being a qualified entity.

The qualified entity may transfer to a donating taxpayer one GSC for each dollar that the donating taxpayer contributes to the qualified entity. The qualified entity must provide the donating taxpayer with documentation reflecting the amount of GSCs transferred to the donating taxpayer for the contribution.

The bill provides that a qualifying entity's net revenues derived from contributions from donating taxpayers receiving GSCs will supplement, and will not supplant, any revenues received by the qualified entity for any other purpose.

For each taxable year beginning on or after January 1, 2019, and before January 1, 2024, this bill would allow a tax credit in an amount equal to 80 percent of the amount contributed during the taxable year by a taxpayer to a qualified entity from which the taxpayer was transferred GSCs.

Unused credits could be carried over for seven years or until exhausted.

The bill excludes S corporations from claiming this credit at the entity level.

A taxpayer would be required to provide the documentation received from the qualified entity to the Franchise Tax Board (FTB) upon request.

The credit would be allowed in lieu of any charitable deduction otherwise allowed.

The FTB and the State Treasurer would be authorized to prescribe any regulations necessary or appropriate to implement this bill's provisions.

Chapter 3.5 (commencing with Section 11340) of Part 1 of Division 3 of Title 2 of the Government Code would not apply to any rule, guideline, or procedure prescribed by the FTB or the State Treasurer.

The bill states the Legislature's intent to comply with R&TC section 41.

The credit would be repealed by its own terms on December 1, 2024.

### **Implementation Considerations**

Implementing this bill would not significantly impact the department's programs and operations.

### **Technical Considerations**

To repeal the GSC credit, rather than section in which the credit resides, the bill should be amended on page 5, line 18 "section" should be replaced with "Part".

### **Legislative History**

A review of the past five legislative sessions did not locate a tax credit similar to the credit this bill would allow.

### **Other States' Information**

*Florida, Illinois, Massachusetts, Michigan, Minnesota, and New York* laws do not provide a credit comparable to the one that would be allowed by this bill. The laws of these states were selected due to their similarities to California's economy, business entity types, and tax laws.

### **Fiscal Impact**

This bill would not significantly impact the department's costs.

## **Economic Impact**

### Revenue Estimate

This bill would allow a qualifying entity to transfer one GSC for each dollar contributed by a donating taxpayer to qualified entity. The donating taxpayer would receive a credit of 80 percent of the amount contributed. In the revenue analysis of this bill, the FTB noted five potential revenue impacts that would result from taxpayer behavioral changes and potential tax consequences. This bill provides that any monies collected by the State Treasurer would be first allocated to the State Treasurer for costs incurred in connection with the State Treasurer's duties under this part and all remaining monies would be deposited into the general fund.

Although the overall impact to the general fund is unknown, it is estimated that this bill would result in a net increase in the general fund. For example, for every \$1 million that a taxpayer contributes to and receives GSCs from a qualified entity, the entity would pay \$900,000 to the State Treasurer and the taxpayer would be eligible for \$800,000 of tax credits. Assuming that participating taxpayers have sufficient tax liability to fully utilize the credit in the year purchased, there would be a decrease in tax revenue of \$800,000. The net effect to the state would be a gain of \$100,000 (\$900,000 payment from the qualified entity minus \$800,000 reduction in taxes).

First, some taxpayers may generate credits that are larger than their tax liability before credits. Since the credit is nonrefundable, any excess credits not used in the year would result in an acceleration of receipts to the state from the time of the purchase until the taxpayer is ultimately able to apply the credit. We anticipate this effect to be small.

Second, if some taxpayers continue to make regular estimated payments and withholding, in addition to receiving a credit for GSCs from qualifying entities, they may receive refunds of their estimated payments and withholding overpayments after filing their tax return. To the extent GSCs are transferred to taxpayers in the second half of the calendar year and tax refunds are issued in the first half of the following calendar year, there would be a minimal net impact to the general fund because they occur in the same fiscal year. If, however, transfers are made in the first half of the calendar year or if refunds are not issued until the second half of the subsequent year (likely for extension filers), there would be an acceleration of receipts to the general fund.

Third, if taxpayers reduce withholding and estimated payments in the first half of the calendar year (fiscal year 1) then subsequently the taxpayer makes a large contribution and receives GSCs near the end of the calendar year (fiscal year 2), receipts would be shifted from fiscal year 1 to fiscal year 2. (Note, taxpayers would not owe an estimated tax penalty as long as their withholding and estimated payments are sufficient to cover their after-credit liability).

Fourth, a qualified entity may submit a claim for refund to the State Treasurer equal to the amount that the qualified entity transferred to the State Treasurer for GSCs that a qualified entity was unable to transfer to a donating taxpayer. Upon appropriation by the Legislature from the general fund to the State Treasurer, the State Treasurer would make refunds to the qualified entities. This would result in an unknown offset to the general fund since the amount of claims for refunds are unknown.

Fifth, the IRS may rule that the transfer of credits by qualified entities would be considered “non-essential governmental function” or unrelated business income. If so, the difference between the amount transferred to the State Treasurer by the qualified entity and the amount contributed by the donating taxpayer for GSCs may be taxable to the entity. As a result, there could be a revenue gain in an unknown amount.

Unfortunately, the FTB has no way to predict the magnitude of any of these behavioral responses. If the majority of itemizing taxpayers shift the majority of their payments from the first half of the year to the end of the year, the revenue transfer across fiscal years would be in the low tens of billions of dollars. The FTB expects the actual revenue transfer to be significantly less than that by an unknown amount.

### **Support/Opposition**

Support: None provided.

Opposition: None provided.

### **Arguments**

Proponents: Some may argue allowing a tax credit would provide a greater incentive to taxpayers to contribute funds to tax-exempt organizations or educational institutions rather than a tax deduction.

Opponents: Some may argue the tax laws already provide incentive to contribute funds to tax-exempt organizations or educational institutions by allowing a charitable tax deduction.

### **Policy Concerns**

The transfers of monetary amounts for GSC could be deemed unrelated to the charitable purpose and thereby taxable to the charitable organization as unrelated business income.

Because the contributor receives a substantial California tax credit with respect to the contribution, the deduction could be subject to challenge by the Internal Revenue Service.

The bill language is permissive regarding a qualified entity transferring a GSC to the donating taxpayer. Should the qualified entity fail to transfer the GSC the taxpayer will not be able to claim the tax credit.

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