



Analysis of Amended Bill

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Sponsor:

Bill Number: AB 2480

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Introduced: February 14, 2018
and Amended: March 19, 2018

Attorney: Bruce Langston

Related Bills: See Legislative
History

Subject: Contributions to Scholarship Granting Organization Credit/Scholarship Tax Credit Program Act

Summary

This bill would, under the Personal Income Tax Law (PITL) and the Corporation Tax Law (CTL), provide a tax credit for contributions made to a scholarship granting organization.

The bill would also set forth requirements for the Employment Development Department and the State Department of Education. These requirements do not affect the department and are not discussed in this analysis.

Recommendation – No position.

Summary of Amendments

The March 19, 2018, amendments added a coauthor, modified the bill's operative date, and made several technical changes.

This is the department's first analysis of the bill.

Reason for the Bill

The reason for this bill is to encourage contributions to support scholarship granting organizations for eligible students, in order to help cover costs at qualified schools.

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, 2019.

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 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 on the portion that exceeds 2 percent of adjusted gross income, may be deducted. Also, itemized deductions may be further limited for high-income taxpayers.

Current federal and state laws generally allow taxpayers engaged in a trade or business to deduct all expenses that are considered ordinary and necessary in conducting that trade or business. Corporations are also allowed to deduct eligible charitable contributions from income for the calendar year in which the contributions are made.

This Bill

The bill would, under the PITL and the CTL, for each taxable year beginning on or after January 1, 2019, allow a qualified taxpayer a credit in an amount equal to the total contributions made to a scholarship granting organization during the taxable year not to exceed 100 percent of the qualified taxpayer's tax for the taxable year.

If the credit allowed by this bill exceeds the tax liability, the excess may be carried over to reduce the net tax liability in the following year, and the succeeding year if necessary, until the credit is exhausted.

Any deduction otherwise allowed under this part for any amount paid or incurred by the taxpayer upon which the credit is based would be reduced by the amount of the credit allowed.

This bill would define the following terms:

“Educational scholarship” means a grant made to an eligible student to cover all or part of the tuition and fees, including transportation to a qualified school outside of the eligible student's resident school district, at a qualified school.

“Eligible student” means either of the following:

- A student who is a member of a household whose total annual income during the calendar year before the receipt of an educational scholarship from a scholarship granting organization does not exceed an amount equal to two and one-half times the income standard used to qualify for a free or reduced-price lunch under the National School Lunch Act (42 U.S.C. Sec. 1751 et seq.), and who was eligible to attend a public school in the semester preceding the receipt of the educational scholarship or is attending school in California for the first time, and who resides in California while receiving the educational scholarship.
- A student who qualifies for a free or reduced-price lunch under the National School Lunch Act (42 U.S.C. Sec. 1751 et seq.).

Additionally, a student remains an “eligible student” until the student graduates high school or reaches 21 years of age regardless of household income.

“Parent” means a parent, a legal guardian, a conservator, a person acting as a parent of a child, or any other person with legal authority to act on behalf of the child.

“Qualified school” means a public elementary or secondary school located in California that is outside of the eligible student’s resident school district or a private elementary or secondary school in California that complies with the requirements of this bill’s provisions. A qualified school shall comply with all state laws that apply to private schools regarding criminal background checks for employees and exclude from employment any person not permitted by state law to work in a school.

“Qualified taxpayer” under the PITL provisions means a taxpayer who files an income tax return in this state and is not claimed as a dependent for income tax purposes by any other taxpayer.

“Qualified taxpayer” under the CTL provisions means a taxpayer who files a franchise tax return in this state.

“Scholarship granting organization” means an organization that complies with the requirements of this bill and provides educational scholarships to eligible students attending qualified schools of their parent’s choice.

“Test” means either the Standardized Testing and Reporting Program or a nationally norm-referenced test chosen by the qualifying school.

No credit would be allowed unless the scholarship granting organization does all of the following:

- Notifies the Franchise Tax Board (FTB) of its intent to provide educational scholarships to eligible students attending qualified schools.
- Provides the FTB with a letter of determination from the Internal Revenue Service of tax-exempt status as an organization described in Section 501(c)(3) of the Internal Revenue Code.
- Provides the qualified taxpayer with an FTB-approved receipt substantiating the contribution made by the qualified taxpayer to the scholarship granting organization.
- Ensures that at least 90 percent of its revenue from donations is expended on educational scholarships.
- Spends a portion of expenditures each year on educational scholarships for students that qualify for free or reduced price-lunch under the National School Lunch Act equal to the percentage of low-income eligible students in the county where the scholarship granting organization expends the majority of its educational scholarships.
- Cooperates with the FTB, or its designee, in conducting criminal background checks for all of its employees and board members and excludes from employment or governance any individual who might reasonably pose a risk to the appropriate use of contributed funds.

- Ensures that educational scholarships are portable during the school year and may be used at any qualified school that accepts the eligible student according to a parent's wishes. If an eligible student moves to a new qualified school during a school year, the educational scholarship may be prorated.
- Demonstrates its financial accountability to the FTB by submitting a financial information report, conducted by a certified public accountant that complies with uniform financial accounting standards and is certified by an auditor as free of material misstatements.
- If a scholarship granting organization provides five hundred thousand dollars (\$500,000) or more in scholarships to eligible students through this program, it would provide to the FTB a report on the results of an annual financial audit of the organization or its relevant accounts and records pertaining to credit eligibility donations conducted by an independent certified public accountant in accordance with auditing standards generally accepted in the United States, government auditing standards, and rules promulgated by the FTB. The audit report must include a report on financial statements presented in accordance with generally accepted accounting principles. Audit reports must be provided to the FTB within 180 days after completion of the scholarship granting organization's fiscal year. The FTB must review all audit reports submitted. The FTB must require any significant items that were omitted in violation of a rule adopted by the FTB. The items must be provided within 45 days of the date of the request.
- Ensures that educational scholarships are not provided to eligible students to attend a qualified school with paid staff or board members, or relatives thereof, in common with the scholarship granting organization.
- Prioritize the awarding of scholarships to first-time recipients in the following order:
 1. Siblings of students who are currently receiving a scholarship.
 2. Low-income students.
- Grant only one year of scholarship in one approval process.

The bill further provides that no credit would be allowed unless a qualified school that accepts educational scholarships from a scholarship granting organization does all of the following:

- Complies with all health and safety laws or codes that apply to schools.
- Obtains a valid occupancy permit for its grounds if required by its municipality.
- Certifies that it will not discriminate in accordance with Section 1981 of Title 42 of the United States Code.
- Provides academic accountability to the parent of eligible students who receive educational scholarships by regularly reporting to the parent on the student's progress.
- Exclude from employment any person not permitted by law to work in a school.

- Annually administer either the Standardized Testing and Reporting Program or national norm-referenced tests that measure learning gains in math and language arts, and may provide for value-added assessment, to all participating students in grades that require testing under accountability testing laws for schools.
- Pay for tests of scholarship students with the scholarship moneys distributed by the scholarship organizations.
- Provide the parent of each student who was tested with a copy of the results of the tests on an annual basis, beginning with the first year of testing after January 1, 2018.
- Provide the test results to the state department of education on an annual bases.
- Report student information that would allow the state to aggregate data by grade level, gender, family income level, and race.
- Provide rates of high school graduation for participating students to the State Department of Education in a manner consistent with nationally recognized standards.
- Provide the results from an annual parental satisfaction survey, including information about the number of years that the parent's child has participated in the scholarship program to the State Department of Education. The annual satisfaction survey must ask parents of eligible students receiving educational scholarships to express:
 1. Their satisfaction with their child's academic achievement, including academic achievement at the school their child attended through the scholarship program versus academic achievement at the school previously attended, if applicable.
 2. Their satisfaction with school safety at the school their child attends including school safety at the school their child attended through the scholarship program versus academic achievement at the school previously attended, if applicable.
 3. Whether their child would have been able to attend their school of choice without the scholarship.
 4. Their opinions on other topics, items, or issues that the State Department of Education determines would elicit information about the effectiveness of the scholarship program.
- If a private school receives donations of fifty thousand dollars (\$50,000) or more during the school year, the private school would be required to demonstrate its financial accountability by either of the following:
 1. Filing a surety bond with the FTB, payable to the State of California, in an amount equal to the aggregate amount of contributions expected to be received during the school year.

2. Filing financial information prior to the school year with the FTB that demonstrates the financial viability of the scholarship granting organization.

On or before June 1 of each calendar year, a scholarship granting organization would be required to report to the FTB the following information prepared by a certified public accountant regarding the previous calendar year's educational scholarships:

- The name and address of the scholarship granting organization.
- The total number and dollar amount of contributions received during the previous calendar year.
- The total number and dollar amount of educational scholarships awarded during the previous calendar year, the total number and total dollar amount of educational scholarships awarded during the previous year to eligible students qualifying for the federal free and reduced-price lunch program, and the percentage of first-time recipients of educational scholarships who were continuously enrolled in a public school during the previous year.

The FTB must do all of the following:

- Provide a standardized format for a receipt to be issued by the scholarship granting organization to a qualified taxpayer to indicate the value of a received contribution. The FTB would require a qualified taxpayer to provide a copy of this receipt when claiming a credit.
- Provide a standardized format for scholarship granting organizations to report the annual test result information required to be provided by a qualified school to the parent of each student tested.
- Conduct either a financial review or audit of a scholarship granting organization if in possession of evidence of fraud.
- Bar a scholarship granting organization from being a scholarship granting organization if the FTB establishes that the scholarship granting organization has intentionally failed to comply with the bill's requirements. Upon barring a scholarship granting organization, the FTB must notify any affected eligible students and the student's parent of the decision as soon as possible.
- Ensure compliance with privacy laws.

Implementation Considerations

Department staff has identified the following implementation considerations for purposes of a high level discussion; additional concerns may be identified as the bill moves through the legislative process.

It is unclear how the FTB would be able to verify that both the scholarship granting organization and the qualified schools that accept educational scholarships from a scholarship granting organization have met all the requirements of this bill prior to allowing a tax credit.

The author may wish to designate a state agency with expertise in administering financial aid, for example the Department of Education, as the administering agency.

This bill lacks a funding mechanism for the administrative costs associated with the mandated activities. Lack of funding could result in delays in implementation as well as impact the department's ability to meet its core mission

It is unprecedented that a state agency, in this case the FTB, would be required to assist a non-profit organization to conduct background checks for all of its employees and board members and excludes from employment or governance any individual who might reasonably pose a risk to the appropriate use of contributed funds. The author may want to amend the bill to require the scholarship granting organization to obtain the background checks.

The bill lacks administrative detail necessary to implement this credit. For example, the bill is silent on the following:

- What does "bar a scholarship organization" mean? How would the FTB make that determination and notify affected students and parents?
- What is the FTB is to do with any submitted financial information reports or results of an annual financial audit of the organization or its relevant accounts and records pertaining to credit eligibility donations, and surety bonds, and under what timeframes?.

The bill requires on or before June 1 of each calendar year, a scholarship granting organization to report to the FTB the total number and dollar amount of contributions received during the previous calendar year. In order to allow the FTB to verify tax credits claimed the bill should be amended to require the taxpayer's name, tax identification number, and dollar amount received in the previous calendar year and the due date should be changed to on or before January 31 of each calendar year.

For clarity and to ensure consistency with the author's intent, the provisions that describe the responsibilities of the Employment Development and the State Department of Education should be removed from the Income and Franchise Tax provisions of the Revenue and Taxation Code and placed in the California Code relevant to those state agencies.

Because the bill would limit the credit to 100 percent of a qualified taxpayer's tax liability in the taxable year, there would be no credit available for carryover. If this is contrary to the author's intent this bill should be amended.

For consistency with the operative date change and to avoid confusion, the author may wish to amend the bill to substitute January 1, 2019, for January 1, 2018, as the initial year of testing with regard to test results that must be reported to a parent.

Legislative History

AB 2422 (Nestande, 2013/2014) would have created a tax credit under the CTL for monetary contributions to nonprofit organizations that support innovative programs for K-12 students attending public and private schools. AB 2422 failed to pass out of the Assembly Revenue and Taxation Committee.

AB 2421 (Nestande and Allen, 2013/2014) would have created the Nonprofit Education Scholarship Organization tax credit under the CTL. AB 2421 failed to pass out of the Assembly Appropriations Committee.

AB 943 (Nestande, 2013/2014) would have created credits for monetary contributions to a nonprofit organization that either provides grants to schools to support qualified K-12 innovative programs or that gives scholarships for foster youth or disabled children to attend public or private schools. AB 943 failed to pass out of the Assembly Revenue and Taxation Committee.

AB 2582 (Nestande, 2011/2012), would have created two credits for contributions to a public school for support of cocurricular activities or to an educational improvement organization that supports innovative programs in public schools. AB 2582 failed to pass out of the Assembly Revenue and Taxation Committee.

AB 1542 (Negrete-McLeod, 2011/2012) would have created an income tax credit for contributions made to a local educational advancement program (LEAP) organization. AB 1542 failed to pass out of the Assembly Revenue and Taxation Committee.

AB 279 (Duvall, 2009/2010) would have created an income tax credit for contributions to a scholarship granting organization. AB 279 failed to pass out of the Assembly Revenue and Taxation Committee.

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.

Florida has a corporate tax credit scholarship program known as the Step Up for Students. The tax credit allows corporations to receive a dollar-for-dollar tax credit of up to 75 percent of their state income tax liability for donations made to Scholarship Funding Organizations the tax credit cap amount for the 2017-2018 fiscal year is \$698,852,539. Florida does not have a personal income tax.

Illinois enacted the Invest In Kids Scholarship Tax Credit Program in 2017. This program offers a 75 percent income tax credit to individuals and businesses that contribute to qualified Scholarship Granting Organizations.

Minnesota has two programs—the K–12 education subtraction and the K–12 Education Credit, the subtraction and credit may be claimed only to the extent of actual expenses, and the same expenses cannot be used to claim both the subtraction and the credit.

Massachusetts, Michigan, and New York do not provide a credit comparable to the credit allowed by this bill.

Fiscal Impact

Department staff is unable to determine the costs to administer this bill until the implementation concerns have been resolved, but anticipate the costs to implement this new program to be significant.

Economic Impact

Revenue Estimate

This bill would result in the following revenue loss:

Estimated Revenue Impact of AB 2480 as Amended March 19, 2018
For Taxable Years Beginning On or After January 1, 2019
Assumed Enactment after June 30, 2018

(\$ in Millions)

Fiscal Year	Revenue
2018-2019	- \$9.8
2019-2020	- \$32
2020-2021	- \$55

This analysis does not account for changes in employment, personal income, or gross state product that could result from this bill or for the net final payment method of accrual.

Revenue Discussion

The revenue impact of this bill depends on the amount of annual contributions to qualified scholarship granting organizations and the amount of credits that qualified taxpayers would claim annually.

The FTB data on charitable contributions reported on personal and corporate income tax returns totaled \$44 billion in taxable year 2015. Analysis of contribution data from various resources indicated that 15 percent, or \$7 billion, of contributions are made to education related organizations. It is assumed that 1 percent, or \$70 million, of these contributions would be redirected to qualified scholarship granting organizations (this includes the incentive increase due to the credit). This amount was adjusted to reflect changes in the economy over time. Although the bill is operative for taxable years beginning on or after January 1, 2019, it is assumed that it will take 6 to 12 months before the donation infrastructure, to support these contributions, is ready. It is then assumed that there would be a short phase in period as taxpayers learn about the credit, resulting in an estimated amount of donation of \$38 million in taxable year 2019, \$80 million in taxable year 2020, increasing to \$130 million in taxable year 2025. Multiplying times a credit percent of 100, results in \$38 million in credit generated for

taxable year 2019. It is estimated that 55 percent of the credit would be used in the year generated and the remaining amount would be used over the next two years.

This bill specifies that the contribution deduction would be reduced by the amount of the credit allowed. To arrive at the offsetting tax effect of contribution deductions that would be otherwise allowed under current law, the credit amount is multiplied by the average marginal tax rate resulting in an estimated \$1.2 million offsetting gain in taxable year 2019. This results in a \$19 million revenue loss in taxable 2019, and increases to \$79 million in taxable year 2025.

The calendar year estimates are converted to fiscal years and then rounded to arrive at the amounts shown in the above table.

Support/Opposition

Support: None provided.

Opposition: None provided.

Arguments

Proponents: Some could argue that this credit would provide funding to support enhanced educational opportunities for California's students.

Opponents: Some may argue that these credits could constitute an indirect subsidy of public funds to religious schools and severely impact the state's fiscal health.

Policy Concerns

Generally, credits are limited as a percentage of amounts paid or incurred. This bill would allow a 100 percent credit, which is unprecedented.

This bill lacks a sunset date. Sunset dates generally are provided to allow periodic review of the effectiveness of the credit by the Legislature.

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