

ANALYSIS OF AMENDED BILL

Author:	<u>Reyes</u>	Analyst:	<u>Davi Milam</u>	Bill Number:	<u>AB 647</u>
Related Bills:	<u>See Legislative History</u>	Telephone:	<u>845-2551</u>	Amended Date:	<u>March 21, 2017</u>
		Attorney:	<u>Bruce Langston</u>	Sponsor:	<u></u>

SUBJECT: Refundable Community College Full-Time Student Expenses Credit

SUMMARY

This bill would, under the Personal Income Tax Law (PITL), allow a refundable tax credit for certain community college student expenses.

RECOMMENDATION – NO POSITION**Summary of Amendments**

The March 21, 2017, amendments removed provisions of the bill relating to the gross premiums tax on insurers and replaced them with the provisions discussed in this analysis. This is the department's first analysis of the bill.

REASON FOR THE BILL

The reason for this bill is to reduce costs for students attending a California community college, and to incentivize community college students to pursue full-time enrollment.

EFFECTIVE/OPERATIVE DATE

This bill would be effective January 1, 2018, and specifically operative for taxable years beginning on or after January 1, 2018.

FEDERAL/STATE LAW

Current federal law provides two education-related tax credits: the American Opportunity Credit and the Lifetime Learning Credit.

The American Opportunity Credit allows qualified taxpayers a credit of 100 percent for the first \$2,000 of qualified tuition and related expenses, and 25 percent of the next \$2,000 of qualifying education expenses, for a total tax credit of up to \$2,500 per eligible student per year. Up to 40 percent of the tax credit is refundable. The tax credit is phased out for taxpayers with modified adjusted gross income between \$80,000 and \$90,000 for single filers and between \$160,000 and \$180,000 for joint filers. The tax credit may be claimed for an eligible student for only the first four years of postsecondary education.

The Lifetime Learning Credit allows qualified taxpayers a nonrefundable credit of 20 percent of the first \$10,000 of qualified tuition for a total of up to \$2,000 per taxable year. The tax credit is phased out for taxpayers with modified adjusted gross income between \$55,000 and \$65,000 for single filers and between \$111,000 and \$131,000 for joint filers. The credit is available for an unlimited number of tax years.

In lieu of the above credits, qualified taxpayers may claim a deduction in computing adjusted gross income for qualified education expenses, not to exceed \$4,000.

Federal law defines “qualified tuition and related expenses” as tuition and fees required for the enrollment or attendance of the taxpayer, the taxpayer’s spouse or any dependent for which the taxpayer is allowed a dependent exemption deduction.¹

Federal law requires that an educational institution provide a Form 1098-T *Tuition Statement*² that includes specified information, including:

- The name, address, and taxpayer identification number of the individual enrolled at the educational institution.
- The amount of payments received for tuition and related expenses.
- The aggregate amount of grants received by the individual for payment of the costs of attendance.
- Other information specified by the Secretary.

Current state law does not provide any tax credits related to paid or incurred education expenses.

Under Revenue and Taxation Code (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

For each taxable year beginning on or after January 1, 2018, this bill would, under the PITL, allow a credit against the “net tax,” to a qualified taxpayer in an amount equal to the qualified community college expenses paid or incurred during the taxable year.

- “Qualified community college expenses” means fees and other expenses paid or incurred for the enrollment or attendance of a qualified full-time community college student in a California community college as does not exceed two thousand dollars (\$2,000) per qualified full-time community college student.

¹ Internal Revenue Code section 25(A)(f).

² <https://www.irs.gov/pub/irs-pdf/f1098t.pdf>

- “Qualified full-time community college student” means an individual for whom both of the following apply:
 - The individual completed an academic year of full-time enrollment in a California community college that concluded during the taxable year.
 - The individual has not been considered a qualified full-time community college student for the purposes of the credit allowed by this bill for any prior taxable year.
- “Qualified taxpayer” means a taxpayer who is a qualified full-time community college student or who has a dependent who is a qualified full-time community college student.

A qualified taxpayer would be required to submit with his or her return, a copy of the transcript of the qualified full-time community college student evidencing completion of an academic year of full-time enrollment in a California community college.

If the amount allowable as a credit under the terms of this bill exceeds the tax liability for the taxable year, the excess would be credited against other amounts due, if any, and the balance, if any, upon appropriation by the Legislature, would be paid to the qualified taxpayer.

To comply with R&TC section 41, this bill would require the Legislative Analyst’s Office to collect and remit specified data to the Legislature.

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. Department staff is available to work with the author’s office to resolve these and other concerns that may be identified.

This bill lacks administrative details necessary to implement the bill and determine its impacts to the department’s systems, forms, and processes. The bill is silent on the following issues:

- It is unclear whether the credit would be \$4,000 per qualified community college student for qualified taxpayers filing married filing jointly. Additionally, it is unclear whether the \$2,000 credit could be claimed by both the student and the student’s parent.
- If the qualified community college student receives financial assistance for the community college expenses must the creditable amount be reduced by the amount of any assistance?

For clarity and ease of administration, it is recommended that the bill be amended.

The bill uses undefined terms and phrases that could be broadly interpreted, i.e. “fees,” “other expenses,” and “dependent”. The use of undefined terms and phrases could lead to disputes with taxpayers and would complicate the administration of this bill. For clarity and ease of administration, it is recommended that the bill be amended to define these terms by reference to federal law, forms, and instructions.

Additionally, it is unclear what is meant by “completed an academic year of full-time enrollment.” Since the bill lacks language clarifying what is meant by “full-time,” it is unclear how many classes or units must be taken, or whether the student must be enrolled in a degree or certificate program. It also could be argued that merely attending community college for the academic year without successfully passing courses or making progress towards a degree or certificate would qualify. To ensure consistency with the author’s intent, it is recommended that the bill be amended.

This bill would require regular annual appropriations by the Legislature to pay for the refundable portion of this credit. If there are insufficient funds available to cover all of the refunds due, the department would suspend payment of the refunds until additional funds were appropriated. Interest would have to be paid to refund recipients for the period the refund was delayed. This delay would result in additional contacts to the department by refund recipients, which would likely increase departmental costs. This concern could be alleviated by amending the bill to specify that the balance of any excess credit would be paid from the Tax Relief and Refund Account and refunded to the taxpayer.

LEGISLATIVE HISTORY

AB 1441 (Beall, 2011/2012) would have created a credit for qualified costs paid or incurred at the University of California, the California State University, or the California Community Colleges. AB 1441 failed to pass out of the Assembly by the constitutional deadline.

AB 1079 (Beall, 2011/2012) would have created a credit for qualified costs paid or incurred at the University of California or the California State University. AB 1079 failed to pass out of the Assembly by the constitutional deadline.

OTHER STATES’ INFORMATION

The states surveyed include *Illinois, Massachusetts, Michigan, Minnesota, and New York*. These states were selected due to their similarities to California's economy and tax laws. With the exception of *New York*, none of these states provide a tax credit similar to that proposed by this bill.

New York provides a college tuition expenses tax credit of up to \$400 per student, per year.

FISCAL IMPACT

The department’s costs to implement this bill have yet to be determined, but are anticipated to be significant. As the bill moves through the legislative process and the implementation considerations 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 647 As Amended on March 21, 2017 Assumed Enactment After June 30, 2017 (\$ in Millions)		
2017-18	2018-19	2019-20
- \$550	- \$550	- \$270

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

Revenue Discussion

Based on historical data from the California Community Colleges Chancellor's Office, there will be 500,000 full-time students enrolled in California community colleges in the 2018 taxable year. This estimate assumes a full-time student would enroll in 12 or more units each term annually.

Because qualified expenses would exceed \$2,000 per year for each full-time student, qualified taxpayers would claim the maximum credit. It is assumed 90 percent, or 450,000 taxpayers, would take the maximum credit in the first year resulting in an estimated \$900 million in credits generated in the 2018 taxable year. This estimate assumes the Legislature would appropriate funds for a refundable credit resulting in an estimated revenue loss of \$900 million in 2018.

The estimated number of qualified students would decrease to 135,000 in 2019 because students would have claimed the credit in the previous year. This estimate includes an increase for part-time students incentivized to pursue full-time enrollment. Therefore, the revenue loss is estimated to be \$270 million in 2019 and \$275 million in 2020.

The tax year estimates are converted to fiscal years, and then rounded to arrive at the estimates reflected in the above table.

SUPPORT/OPPOSITION

Support: None provided.

Opposition: None provided.

ARGUMENTS

Proponents: Some may say that the financial incentive that this bill would provide would encourage more community college students to pursue full-time enrollment.

Opponents: Some could argue that providing a state credit when a federal credit is available for higher education expenses may unnecessarily divert limited state resources from other social programs that may lack similar funding.

POLICY CONCERNS

The department is concerned with the possibility of fraud. The Internal Revenue Service has historically experienced a high rate of improper payments with refundable credits. The improper payments can stem from honest mistakes; however many are related to fraud and identity theft. These concerns are aggravated if a refund is made that is later determined to be fraudulent. In such cases the refund commonly cannot be recovered.

This bill would allow taxpayers in certain circumstances to claim multiple tax benefits for the same item of expense.

Generally, credits are limited as a percentage of amounts paid or incurred. This bill would potentially allow a taxpayer to obtain combined federal and state credits that exceed 100 percent of expenses.

An individual who claimed even one dollar of qualifying expenses in a prior year would be ineligible to claim a credit in a subsequent year. To avoid this situation, the author may wish to make the credit limit cumulative providing a maximum credit over the life of the credit of \$2,000 per qualified full-time community college student.

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

LEGISLATIVE STAFF CONTACT

Davi Milam
Legislative Analyst, FTB
(916) 845-2551
davi.milam@ftb.ca.gov

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

Diane Deatherage
Legislative Director, FTB
(916) 845-6333
diane.deatherage@ftb.ca.gov