STATE OF CALIFORNIA
Franchise Tax Board

Analysis of Amended Bill

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Subject: Dependent Child, Parent, or Stepparent Care Expenses and/or Trust Fund Contributions Deduction

Summary

This bill, under the Personal Income Tax Law (PITL), would create deductions from gross income for the following expenses:

Provision No.1: The care of a dependent parent or stepparent.

Provision No.2: The care of a dependent child, as defined.

Provision No.3: Contributions to a qualified trust fund, as specified.

Recommendation – No position.

Summary of Amendments

The March 22, 2018, amendments removed provisions of the bill related to personal income tax rates and residency determination 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 the bill is to help struggling families who care for their disabled children, siblings or parents.

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.

Economic Impact – Summary Revenue Table

This bill would result in the following revenue loss:

Estimated Revenue Impact of SB 1352 as Amended on March 22, 2018
For Taxable Years Beginning On or After January 1, 2019
Assumed Enactment after June 30, 2018

($ in Billions)

Fiscal Year	Revenue
2018-2019	- $3.7
2019-2020	- $8.7
2020-2021	- $11.0

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.

Federal/State Law

Existing federal and state laws allow for the deduction of certain expenses from gross income when calculating adjusted gross income (AGI),[1] such as 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.[2] 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.

Existing federal and state laws allow contributions to Achieving a Better Life Experience Accounts (ABLE accounts) for the qualified disability expenses of the designated beneficiary of the account. Amounts in the account accumulate on a tax-free basis. Distributions from an ABLE account are generally excludable from income to the extent that the total distribution does not exceed the qualified disability expenses of the beneficiary during the taxable year.

Existing federal and state laws allow a Child and Dependent Care Expenses credit for employment-related costs of care for a qualifying individual. The credit percentage varies depending on the taxpayer's AGI. A qualifying individual is defined as a dependent of the taxpayer that is under the age of 13 or a dependent or spouse who is physically or mentally

[1] Internal Revenue Code section 62. Revenue and Taxation Code section 17072.
[2] On December 22, 2017, President Trump signed into law H.R. 1, originally known as the Tax Cuts and Jobs Act of 2017. The moving expense deduction was suspended for tax years beginning after December 31, 2017, and before December 31, 2025. For federal income tax purposes, the alimony deduction is eliminated for any divorce commencing after December 31, 2018.

unable to provide self-care. Employment-related expenses are generally defined as those expenses incurred to enable gainful employment.

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

Provision No.1: Deduction for care of a dependent parent or stepparent.

For each taxable year beginning on or after January 1, 2019, this provision, under the PITL, would allow a deduction in determining AGI for qualified expenses paid or incurred during the taxable year by a qualified taxpayer for the care of the qualified taxpayer's dependent parent or stepparent.

This provision would define the following terms and phrases:

- "Dependent parent or stepparent" means the parent or stepparent of a qualified taxpayer who can no longer care for himself or herself, as documented by a health care professional, including, but not limited to, an allopathic physician, an osteopathic physician, or a registered nurse practitioner.
- "Qualified expenses" mean those expenses for the care of the qualified taxpayer's dependent parent or stepparent that are greater than five thousand dollars ($5,000) and do not exceed thirty thousand dollars ($30,000).
- "Qualified taxpayer" means:
    - Taxpayers who filed as married individuals filing a joint return, filed a head of household (HOH) return, or filed as a surviving spouse, who have a gross income for the taxable year of no more than two hundred fifty thousand dollars ($250,000).
    - A taxpayer who filed as a single taxpayer or filed as a married individual filing a separate return, who has a gross income for the taxable year of no more than one hundred twenty five thousand dollars ($125,000).

The Franchise Tax Board (FTB) would be required to annually recompute the gross income and qualified expense amounts for taxable years beginning on or after January 1, 2020, and each year thereafter, as specified.

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.

It is unclear whether the deduction limitation would apply to the amount of deduction per taxable year, the qualified expenses per taxable year, or the amount of expenses per dependent parent or stepparent per taxable year.

Because the provision fails to specify otherwise, every child of a “dependent parent or stepparent” could be a qualified taxpayer eligible for the deduction this provision would allow. If this is contrary to the author’s intent, this bill should be amended.

This provision uses terms and phrases that are undefined, i.e., “dependent,” “parent,” “stepparent,” “no longer care for himself or herself,” “documented by a health care professional,” and “allopathic physician.” The absence of definitions to clarify these terms could lead to disputes with taxpayers and would complicate the administration of this provision.

The defined phrase “qualified expenses” could be more broadly interpreted than the author intends. For example, it could be argued that any expense for a parent or stepparent’s personal care, including housekeeping, hair appointments, car services, and any other daily living expenses would qualify for the deduction. If this is inconsistent with the author’s intent, this provision should be amended.

The department lacks the expertise to determine whether an individual “can no longer care for himself or herself.” Because the provision is silent on any specified activities of daily living and the period of time the assistance is required, it could be argued that any parent could be “documented” as requiring care. If this is inconsistent with the author’s intent, the provision should be amended.

The defined term “qualified taxpayer” uses the term “gross income;” however, 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.

Legislative History

AB 806 (Kalra, 2017/2018) would have created a family caregiver credit. AB 806 failed to pass by the constitutional deadline.

AB 298 (Berg, 2005/2006) would have extended the long-term caregiver credit to taxable years beginning on or before January 1, 2011. AB 298 failed to pass by the constitutional deadline.

Other States’ Information

Illinois, Massachusetts, Michigan, Minnesota, and *New York* laws do not provide a tax deduction comparable to the deduction that would be allowed by this provision. However, *Massachusetts* allows a deduction for employment-related expenses for the care of a qualified child, disabled dependent, or a disabled spouse. The maximum deduction is $4,800 for one qualifying individual and $9,600 for two or more qualifying individuals. The laws of these states were selected due to their similarities to California's economy, business entity types, and tax laws.

Fiscal Impact

The department’s costs to implement this provision have yet to be determined. As the bill moves through the legislative process, costs will be identified.

Economic Impact

Revenue Estimate

This provision would result in the following revenue loss:

($ in Millions)

Fiscal Year	Revenue
2018-2019	- $330
2019-2020	- $650
2020-2021	- $700

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

Based on a study by the American Association of Retired Persons (AARP) on caregiving costs and US Census data, it is estimated there would be 2.1 million taxpayers that care for a dependent parent or stepparent in 2019. Due to the timing of the legislation, it is assumed 80 percent, or 1.7 million taxpayers, would claim the deduction in 2019 and 95 percent each year thereafter. It is estimated 90 percent, or 1.5 million taxpayers, would meet the gross income limitation specified in the bill. It is further assumed taxpayers would care for one to three parents, equating to 1.8 million care recipients. It is estimated that the average qualifying expenses would be $10,000 per care recipient, or $18 billion in total qualified expenses in 2019. Applying an average tax rate of 3 percent results in an estimated revenue loss of $550 million in 2019.

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

Provision No.2: Deduction for the care of a dependent child

For each taxable year beginning on or after January 1, 2019, this provision, under the PITL, would allow a deduction in determining AGI for the qualified expenses paid or incurred during the taxable year by a qualified taxpayer for the care of the qualified taxpayer's dependent child.

This provision would define the following terms and phrases:

- "Dependent child" means the child, stepchild, or a child of whom the qualified taxpayer is the guardian who is a child with special needs, including, but not limited to, a child with Down syndrome, Asperger syndrome, autism, or cerebral palsy.
- "Qualified expenses" mean those expenses for the care of the qualified taxpayer's child that are greater than five thousand dollars ($5,000) and do not exceed thirty thousand dollars ($30,000).

- "Qualified taxpayer" means:
    - Taxpayers who filed as married individuals filing a joint return, filed a HOH return, or filed as a surviving spouse, who have a gross income for the taxable year of no more than two hundred fifty thousand dollars ($250,000).
    - A taxpayer who filed as a single taxpayer or filed as a married individual filing a separate return, who has a gross income for the taxable year of no more than one hundred twenty five thousand dollars ($125,000).

The FTB would be required to annually recompute the gross income and qualified expense amounts for taxable years beginning on or after January 1, 2020, and each year thereafter, as specified.

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.

It is unclear whether the deduction limitation would apply to the amount of deduction per taxable year, the qualified expenses per taxable year, or the amount of expenses per dependent child per taxable year.

Because the provision fails to specify otherwise, every parent of a "dependent child" could be a qualified taxpayer eligible for the deduction this provision would allow. If this is contrary to the author's intent this bill should be amended.

This provision uses terms and phrases that are undefined, i.e., "dependent," "guardian," "special needs," "Down Syndrome," "Asperger syndrome," and "autism." The absence of definitions to clarify these terms could lead to disputes with taxpayers and would complicate the administration of this provision.

The defined phrase "qualified expenses" could be more broadly interpreted than the author intends. For example, it could be argued that any expense for the "care" of a dependent child would qualify for deduction, including food, clothing, and other items unrelated to a special need. If this is inconsistent with the author's intent, the provision should be amended.

This provision lacks a certification requirement by a physician or other health professional with the expertise to make a special needs diagnosis which could result in disputes between taxpayers and the department. For ease of administration and taxpayer certainty, it is recommended that the provision be amended.

The defined term "qualified taxpayer," uses the term "gross income;" however, 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.

Legislative History

AB 230 (Chavez, 2017/2018) would have temporarily increased the Child and Dependent Care Expenses credit. AB 230 failed to pass by the constitutional deadline.

AB 2676 (Chavez, 2015/2016) would have temporarily increased the Child and Dependent Care Expenses credit. AB 2676 failed to pass by the constitutional deadline.

Other States' Information

Illinois, Massachusetts, Michigan, Minnesota, and *New York* laws do not provide a tax deduction comparable to the deduction that would be allowed by this provision. However, *Massachusetts* allows a deduction for employment-related expenses for the care of a qualified child, disabled dependent, or a disabled spouse. The maximum deduction is $4,800 for one qualifying individual and $9,600 for two or more qualifying individuals. The laws of these states were selected due to their similarities to California's economy, business entity types, and tax laws.

Fiscal Impact

The department's costs to implement this provision have yet to be determined. As the bill moves through the legislative process, costs will be identified.

Economic Impact

Revenue Estimate

This provision would result in the following revenue loss:

($ in Billions)

Fiscal Year	Revenue
2018-2019	- $2.2
2019-2020	- $4.1
2020-2021	- $4.3

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

Based on US Census statistics and available data on children living in their parents' home, there would be an estimated 11.1 million children meeting the definition of "dependent child" as specified in the bill. Due to the timing of the legislation, it is assumed 80 percent, or 8.9 million taxpayers would claim the deduction in 2019, and 90 percent each year thereafter. It is estimated 90 percent, or 8 million taxpayers would meet the gross income limitation specified in the bill. It is assumed the average qualified expenses would be $16,000 per care recipient, or $128 billion in total qualified expenses in 2019. Applying an average tax rate of 3 percent results in an estimated revenue loss of $3.8 billion in 2019.

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

Provision No.3: Deduction for contributions to a qualified trust fund

For each taxable year beginning on or after January 1, 2019, this provision, under the PITL, would allow a deduction in determining AGI in an amount equal to the contributions made by a qualified taxpayer during the taxable year to a qualified trust fund.

The deduction would be limited to thirty thousand dollars ($30,000) per taxable year.

This provision would define the following terms and phrases:

- “Dependent child” means a child with special needs, including, but not limited to, a child with Down syndrome, Asperger syndrome, autism, or cerebral palsy.
- “Dependent parent or stepparent” means the parent or stepparent of a qualified taxpayer who can no longer care for himself or herself, as documented by a health care professional, including, but not limited to, an allopathic physician, an osteopathic physician, or a registered nurse practitioner.
- “Qualified taxpayer” means a parent, stepparent, guardian, or grandparent of a dependent child, or the child or stepchild of a dependent parent or stepparent.
- “Qualified trust fund” means a trust fund established to pay for the care, as recommended by a health care professional, and medical expenses of a dependent child or dependent parent or stepparent.

The FTB would be required to annually recompute the deduction limitation for taxable years beginning on or after January 1, 2020, and each year thereafter, as specified.

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.

This provision lacks administrative details necessary to implement the provision. The amount of the deduction and who may claim the deduction is unclear. For example, it is unclear whether:

- The $30,000 limitation per taxable year would apply for each “dependent child” and “dependent parent or stepparent.”
- Only one qualified taxpayer may claim the deduction for contributions or whether the deduction amount would be allocated if more than one qualified taxpayer contributes to the trust.

This provision uses terms and phrases that are undefined, i.e., “dependent,” “special needs,” “Down Syndrome,” “Asperger syndrome,” “autism,” “trust fund,” “health care professional,” “allopathic physician,” and “medical expenses.” The absence of definitions to clarify these terms could lead to disputes with taxpayers and would complicate the administration of this provision.

Although this provision limits the contribution amount subject to deduction, the provision lacks a clear and unambiguous limit on the total amount that may be contributed to the trust fund, who may contribute to the fund, or whether a specified dependent may be the beneficiary of multiple trust accounts.

The provision fails to specify that withdrawals from the qualified trust fund would be excludable from gross income.

Because the provision fails to specify otherwise, a qualified trust fund may remain open indefinitely, allowing contributions and the resulting tax benefits to continue in perpetuity.

Because the provision fails to specify otherwise, earnings with respect to amounts deposited would be subject to income tax in the year received or credited to the trust account.

Legislative History

AB 449 (Irwin, et al., Chapter 774, Statutes of 2015) conformed to the federal tax treatment for ABLE accounts.

Other States’ Information

Illinois, Massachusetts, Michigan, Minnesota, and *New York* laws do not provide a contribution deduction comparable to the deduction that would be allowed by this provision; however, all of the states surveyed allow ABLE accounts. The laws of these states were selected due to their similarities to California's economy, business entity types, and tax laws.

Fiscal Impact

The department’s costs to implement this provision have yet to be determined. As the bill moves through the legislative process, costs will be identified.

Economic Impact

Revenue Estimate

This provision would result in the following revenue loss:

($ in Billions)

Fiscal Year	Revenue
2018-2019	- $1.1
2019-2020	- $3.9
2020-2021	- $5.5

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

Based on AARP data, US Census statistics, and FTB data, there would be an estimated 9.7 million qualified trust fund beneficiaries in California in taxable year 2019. Due to the timing of the legislation, it is assumed 30 percent, or 2.9 million qualified trust fund accounts would be established in 2019, 75 percent in 2020, and 80 percent each year thereafter. It is further assumed that taxpayers could argue that any account established to pay for a dependent child or parent expenses would be a qualifying trust fund. It is estimated that there would be an average annual contribution of $23,000 per year, resulting in $67 billion contributed in 2019, growing to $200 billion in 2021. Applying an average tax rate of 3 percent results in an estimate revenue loss of $2 billion in 2019, growing to $6 billion in taxable year 2021.

The provision fails to specify that withdrawals from the qualified trust fund would be excludable from gross income. The estimates assumes that 90 percent of contributions/deposits would be withdrawn in the year contributed, for total withdrawals of $60 billion in 2019. It is assumed 25 percent of withdrawals would be taxable to the beneficiary and after applying an average tax rate of 1 percent results in an offsetting revenue gain of $150 million in 2019.

Because the provision fails to specify otherwise, earnings on trust fund contributions/deposits would be subject to tax. Thus, the estimate is also offset by a small revenue gain for tax due on any earnings. This results in a net revenue loss of approximately $1.9 billion in 2019 and $5.8 billion in taxable year 2021.

The tax-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 may say that in a time when many working families struggle to pay for the rising cost of family care, this deduction would make family care more affordable.

Opponents: Some may say that providing tax relief to assist with expenses for family care will result in revenue losses, which have to be offset 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.

The deductions provided under provisions one and two would be allowed for qualified expenses paid or incurred either inside or outside California.

This bill would allow taxpayers in certain circumstances to claim multiple tax benefits for the same item of expense. Additionally, a taxpayer could potentially claim all three deductions proposed by this bill for a cumulative tax deduction of $80,000 per taxable year.

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

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