STATE OF CALIFORNIA
Franchise Tax Board

Analysis of Amended Bill

Author: De Leon, et al.	Sponsor:	Bill Number: SB 227
Analyst: Jessica Deitchman	Phone: (916) 845-6310	Amended: January 3, 2018
Attorney: Bruce Langston	Related Bills: See Legislative History	

Subject: California Excellence Fund Tax Credit

Summary

This bill would, under the Personal Income Tax Law (PITL) and the Corporation Tax Law (CTL), allow a credit in the amount equal to the amount contributed by the taxpayer for the taxable year to the California Excellence Fund.

Recommendation – No position.

Summary of Amendments

The January 3, 2018, amendments removed the provisions that made non-substantive changes to the Business and Professions Code and replaced them with the provisions discussed in this analysis. This is the department's first analysis of the bill.

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 allow taxpayers to make a deductible donation to the California Excellence Fund by offering a state tax credit equal to the amount of the donation.

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, 2018.

Federal/State Law

Existing state and federal 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.

Current federal laws lacks a comparable credit for donations to a state government.

One example of a tax credit in California is the College Access Tax Credit. For taxable years beginning on or after January 1, 2018, and before January 1, 2023, current state tax law allows the College Access Tax Credit, in an amount equal to 50 percent of the amount contributed by a taxpayer to the College Access Tax Credit Fund, as allocated and certified by the California Educational Facilities Authority (Authority). The maximum aggregate amount of College Access Tax Credit that may be allocated and certified by the Authority is $500 million.

Taxpayers are precluded from taking a deduction for amounts included in the calculation of the College Access Tax Credit. Any unused College Access Tax Credits may be carried forward for up to six years.

The College Access Tax Credit may reduce tax below tentative minimum tax under both the PITL and the CTL.

Current federal law limits state and local tax deductions to the first $10,000 of tax paid. However, the same limitation is not provided for charitable deductions.

This Bill

This bill would, under the PITL and CTL, for taxable years beginning on or after January 1, 2018, allow a credit against the “net tax”, as defined in Section 17039, in an amount equal to the amount contributed by a taxpayer for the taxable year to the California Excellence Fund.

The California Excellence Fund would be created in the General Fund to accept monetary contributions for exclusively public purposes as specified under Section 170 of the Internal Revenue Code, relating to charitable contributions and gifts.

All amounts in the fund shall be used for those public purposes upon appropriation by the Legislature.

The Treasurer shall do both of the following:

- Establish a procedure for the public to make monetary contributions to the California Excellence Fund and for any taxpayer to obtain from the Treasurer a certification for the credit allowed by this section. The procedure shall require the Treasurer to certify the contribution amount eligible for credit within 45 days following receipt of the contribution.
- Provide the Franchise Tax Board (FTB) a copy of each credit certificate issued for the calendar year by March 1 of the calendar year immediately following the year in which those certificates are issued.

The Treasurer shall adopt any regulations necessary or appropriate to implement this subdivision, and also exempts those regulations from the Administrative Procedure Act.

Taxpayers are precluded from taking a deduction for amounts included in the calculation of the credit. Any unused credits may be carried forward for up to six years.

The provisions of Revenue and Taxation code section 41 shall not apply to this credit.

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.

The bill would allow a credit in an amount equal to the amount donated to the California Excellence Fund and requires the Treasurer to provide the FTB with a copy of each credit certificate issued no later than March 1 of the calendar year immediately following the year in which those credit certificates are issued. Because tax returns are due during different times of the year for corporations, and personal income taxpayers often file before March 1 of the calendar year, the FTB would be unable to verify if the credit claimed on the return is accurate until after the return is filed. For ease of administration, it is recommended that the bill be amended to require a copy of the credit certificate be provided to the FTB sooner.

Additionally, the bill requires the Treasurer to issue a credit certificate to the taxpayer no later than 45 days after the donation is made. Because taxpayers may choose to make multiple donations during the year that would then get multiple credit certificates, for ease of administration and tracking of the credit, the author may wish to consider requiring credit certificates to be issued to the taxpayer on an annual basis.

This bill uses a phrase "an amount contributed <u>for</u> the taxable year." For clarity of when the donation must be made in order to receive a credit, the author may wish to amend the bill to state that the credit would be allowed in "an amount contributed <u>during</u> the taxable year."

Technical Considerations

Because this credit is unable to reduce total tax below tentative minimum tax, there could be a possibility of a taxpayer having a larger California alternative minimum tax.[1] If this was an unintended outcome, the author may wish to amend the bill to allow the credit to reduce tax liability below tentative minimum tax.

Legislative History

AB 490 (Quirk-Silva, Chapter 490, Statutes of 2017) extended the College Access Tax Credit to taxable years beginning on or after January 1, 2018, and before January 1, 2023.

SB 81 (Committee on Budget and Fiscal Review, Chapter 22, Statutes of 2015) extended the College Access Tax Credit to taxable years beginning on or after January 1, 2017, and before January 1, 2018.

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[1] California Revenue and Taxation Code section 17039(c).

SB 798 (De Leon, Chapter 367, Statutes of 2014) created the College Access Tax Credit, an income tax credit for cash contributions made to an education special fund with an aggregate credit cap of $500 million per calendar year.

Other States' Information

Florida, Illinois, Massachusetts, Michigan, Minnesota, and *New York* laws do not provide a credit comparable to the credit/deduction 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

The department's costs to implement this bill have yet to be determined. As the bill moves through the legislative process, costs will be identified and an appropriation will be requested, if necessary.

Economic Impact

Revenue Estimate

This bill would allow taxpayer to make a charitable contribution to the California Excellence Fund. In the analysis of this bill, the FTB noted four potential revenue impacts that would result from taxpayer behavioral changes. This analysis assumes that all contributions made to the California Excellence Fund would be deemed receipts to the General Fund.

First, some taxpayers may make contributions to the California Excellence Fund that are larger than their tax liability before credits. Since the credit is nonrefundable, any excess contribution not used in the year would result in an acceleration of receipts to the state from the time of the contribution 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 making contributions to the California Excellence Fund, they may receive refunds of their estimated payments and withholdings overpayments after filing their tax return. To the extent that contributions are made in the second half of the calendar year and refunds are issued in the first half of the following calendar year, there is a minimal net impact to the General Fund because they occur in the same fiscal year. If, however, contributions 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 will 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 to the California Excellence Fund near the end of the calendar year (fiscal year 2), receipts will be shifted from fiscal year 1 to fiscal year 2. (Note, taxpayers will not owe an estimated tax penalty as long as their withholding and estimated payments are sufficient to cover their after-credit liability).

Fourth, for S-corporations there will be a revenue loss as a result of contributions. S-corporations may take 1/3 of their credits at the entity level and pass 100 percent of their credits through to their shareholders. Thus, a $3,000 contribution to the California Excellence Fund by an S-corporation will result in a $1,000 credit available for use on the S-corporation's return and a $3,000 credit passed through to the shareholders for use on their personal income tax returns. This results in a net loss of $1,000 to the state ($3,000 contribution less $4,000 in credit).

Unfortunately, we have 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. We expect 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 that this bill would encourage taxpayers to donate to the state, thereby increasing state revenues.

Opponents

Some may argue that a monetary contribution is too restrictive and contributions of appreciated capital gain property should be allowed.

Policy Concerns*

This bill fails to limit the amount of the credit that may be taken. Credits that could potentially be quite costly are sometimes limited either on a per-credit or per-taxpayer basis. This bill would provide a 100 percent credit which would be 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.

This bill assumes that the contributions made to the California Excellence Fund would be allowed as a charitable contribution deduction on the federal income tax return. If the Internal Revenue Service or Department of the Treasury disagrees that the contributions qualify as charitable contributions, the author's intent may not be realized.

Legislative Staff Contact

Jessica Deitchman
Legislative Analyst, FTB
(916) 845-6310
jessica.deitchman@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