

## Franchise Tax Board

## ANALYSIS OF ORIGINAL BILL

Author: Galgiani, et al. Analyst: Funmi Obatolu Bill Number: SB 807  
Related Bills: See Legislative History Telephone: 845-5845 Introduced Date: February 17, 2017  
Attorney: Bruce Langston Sponsor: \_\_\_\_\_

**SUBJECT:** Teacher Recruitment Credit and Retention Exclusion

### SUMMARY

This bill would, under the Personal Income Tax Law, allow a tax credit for certain expenses incurred to become a credentialed teacher and an exclusion from gross income of certain income for qualified teachers.

### RECOMMENDATION – NO POSITION

### REASON FOR THE BILL

The reason for the bill is to address the teacher shortage by providing incentives that will promote teacher retention and encourage others to join the teaching profession.

### 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, 2017, and before January 1, 2027.

### FEDERAL/STATE LAW

#### *Tax Credit*

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.

There are currently no federal or state credits comparable to the credit this bill would create.

#### *Exclusions from gross income*

Existing federal and state laws provide that certain types of income are excluded from gross income, such as amounts received as a gift or inheritance, certain compensation for injuries and sickness, qualified scholarships, educational assistance programs, foster care payments, and interest received on certain state or federal obligations.

There are currently no federal or state exclusions comparable to the exclusion this bill would create.

## **THIS BILL**

For each taxable year beginning on or after January 1, 2017, and before January 1, 2027, this bill would allow a qualified taxpayer a credit against the net tax imposed on qualified income in an amount equal to the qualified costs paid or incurred during the taxable year to earn a clear teaching credential.

For purposes of the credit this bill would define the following phrases:

“Qualified costs” include those paid or incurred for any of the following:

- Participation in a program of beginning teacher support assessment.
- Tuition for a master’s degree leading to a clear teaching credential.
- Certification assessments, including performance assessments.
- Tuition for years four and five in an integrated program of professional preparation, as described in Section 44259.1 of the Education Code.

“Qualified income” means any income received by the qualified taxpayer from a teaching position in which at least 50 percent of the work time is spent instructing pupils.

“Qualified taxpayer” means a taxpayer who is a teacher of record in a California school.

A taxpayer does not need to have a clear teaching credential or a full-time position as a teacher of record to be a “qualified taxpayer” for purposes of the credit allowed under this bill.

Unused credits could be carried over for five years, until exhausted.

Also, this bill would exclude from gross income any qualified income received by an eligible teacher on or after January 1, 2017 and before January 1, 2027.

For purposes of the exclusion, the bill would define the following phrases:

“Eligible teacher” is a taxpayer who meets all of the following requirements:

- Is a teacher of record in a California public school teaching any of the grades kindergarten through 12th grade, inclusive.
- Holds a clear teaching credential.
- Is in at least the sixth school year, as described by Section 37200 of the Education Code, as a teacher of record in a California school, for the first year in which the exclusion is allowed.

“Qualified income” means any income received by an eligible teacher from a teaching position in which at least 50 percent of the work time is spent instructing pupils

The Franchise Tax Board (FTB) may issue regulations necessary or appropriate to carry out the purpose of the credit or exclusion.

The Commission on Teacher Credentialing and the State Board of Education would be required to consult with the FTB prior to issuing any regulations.

This bill would be repealed by its own terms as of December 1, 2027.

## **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 uses terms that are undefined, i.e., "clear teaching credential," "participation in a program," "beginning teacher support assessment," "master's degree leading to a clear teaching credential," "certification assessments," "performance assessments," "teacher of record," and "California school." Additionally, the definitions of "qualified costs," and "qualified income" may be more broadly interpreted than the author intends. For example, "qualified costs" could include the cost to travel to the specified activities and "qualified income" could include income received for research or publications. The absence of precise definitions to clarify these terms 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.

The department lacks expertise in teacher certification and credentialing that is the basis for the credit and income exclusion this bill would allow. The author may wish to consider requiring the proper local or state agency to certify that the requirements for the credit and the income exclusions are met and require the taxpayer to obtain, retain and provide to the FTB, upon request, evidence of that certification.

The bill fails to specify the tax rate that would be imposed on "qualified income" for purposes of determining the credit. For example, would the marginal rate for the taxpayer's total income apply? The marginal rate based on only the "qualified income?" To ensure consistency with the author's intent and avoid disputes between taxpayers and the department, this bill should be amended.

The credit would be available to otherwise eligible teachers at both public and private schools, while the income exclusion would be limited to otherwise eligible public school teachers. If the author intends for the income exclusion to apply to both public and private school teachers, this bill must be amended.

Because the bill fails to specify otherwise, the FTB would be subject to the rulemaking procedures required under the Administrative Procedures Act (APA). Following these procedures may delay the implementation of this bill. To prevent any delay, it is recommended that the author add a provision exempting the FTB from the APA when the FTB is prescribing rules, guideline, or procedures necessary or appropriate to carry out the purpose of this bill.

## LEGISLATIVE HISTORY

AB 586 (Holden, 2017/2018) would allow a tax credit and an income tax deduction for certain teacher professional development expenses. AB 586 is currently pending before the Assembly Revenue and Taxation Committee.

## PROGRAM BACKGROUND

For tax years 2000 through 2007, state law allowed a California teacher a nonrefundable credit, up to \$1,500, on wages received for services as a teacher. Eligible teachers were required to file a completed California Form 3505, Teacher Retention Credit to claim the credit. The credit was available for tax years 2000, 2001, and 2003, and was suspended for 2002 and 2004 through 2006, inclusive, for budgetary reasons. The credit was repealed in 2007.

## OTHER STATES' INFORMATION

*Illinois, Massachusetts, Michigan, Minnesota, and New York* laws do not provide tax benefits comparable to the tax benefits 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

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 result in the following revenue losses:

Estimated Revenue Impact of SB 807 As Introduced February 17, 2017 Assumed Enactment After June 30, 2017 (\$ in Millions)			
	2017-18	2018-19	2019-20
Tax Credit Provision	- \$50	- \$75	- \$120
Income Exclusion Provision	- \$1,000	- \$700	- \$700

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

## **Revenue Discussion**

### *Tax Credit*

Based on data from the California Commission on Teacher Credentialing, it is estimated that nearly 25,000 taxpayers would be working toward earning a clear teaching credential in 2017. With an average annual expense of \$7,500, approximately \$185 million in credits would be generated for tax year 2017. It is assumed that 10 percent, or \$19 million, of the credits would be used in the year generated and the remaining credits would be carried forward and used over the next five years.

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

### *Income Exclusion*

Based on data from the California Department of Education in 2015, there were approximately 225,000 qualified teachers working in public schools. With an average salary of roughly \$72,000, approximately \$16 billion would be excluded from gross income. This exclusion amount is adjusted to reflect changes in the economy over time. Applying an average tax rate of 4 percent results in a total revenue loss of \$640 million in taxable year 2017.

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

## **SUPPORT/OPPOSITION**

Support: None provided.

Opposition: None provided.

## **ARGUMENTS**

Proponents: Some may say that this bill would reduce the California teacher shortage by providing crucial financial incentives to California's teachers.

Opponents: Some may argue that the financial incentives would be overly broad and could be an expensive and inefficient way to address California's teacher shortage.

## **POLICY CONCERNS**

This bill would create differences between federal and California tax law, thereby increasing the complexity of California tax return preparation.

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

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

**LEGISLATIVE STAFF CONTACT**

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