



## **Analysis of Amended Bill**

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Bill Number: AB 211

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Introduced January 15, 2019,  
and Amended April 8, 2019

Attorney: Shane Hofeling

Related Bills: See Legislative  
History

**Subject:** Qualified Tuition Program Deduction

### **Summary**

This bill would, under the Personal Income Tax Law (PITL), allow a deduction from gross income equal to the amount of contributions made to a qualified tuition program.

**Recommendation – No position.**

### **Summary of Amendments**

The April 8, 2019, amendments added sunset provisions, modified the operative date, and modified the reporting requirements.

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

### **Reason for the Bill**

The reason for the bill is to encourage Californians to save for college by offering a tax deduction for contributions to the California qualified tuition program, thereby encouraging more Californians to pursue higher education and reducing the amount of student debt.

### **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, 2020, and before January 1, 2025.

### **Federal/State Law**

Internal Revenue Code (IRC) section 529 (Section 529 Plan) provides tax-exempt status to qualified tuition programs.

Contributions to a qualified tuition program must be made in cash. The Section 529 Plan does not impose a specific dollar limit on the amount of contributions, account balances, or prepaid tuition benefits relating to a qualified tuition account; however, the program is required to have adequate safeguards to prevent contributions in excess of amounts necessary to provide for the beneficiary's qualified higher education expenses. Contributions are not tax deductible for federal income tax purposes, but amounts earned in the account (i.e. interest) accumulate on a tax-free basis.

Distributions from a qualified tuition program are excludable from federal tax if used for the beneficiary's qualified higher education expenses. If a distribution from a qualified tuition program exceeds the qualified higher education expenses incurred for the beneficiary, the portion of the excess that is treated as earnings generally is subject to income tax and an additional 10-percent tax. Amounts in a qualified tuition program may be rolled over to another qualified tuition program for the same beneficiary or for a member of the family of that beneficiary.

California conforms, with modifications, to Section 529 Plans as of the "specified date" of January 1, 2015, as they relate to tax-exempt qualified tuition programs. California modifies the additional 10-percent tax on excess distributions to instead be an additional tax of 2.5 percent for state purposes.

Similar to federal law, state law provides that contributions made to a qualified tuition program are not deductible.

Existing federal and state laws allow for the deduction of certain expenses, from gross income, when calculating Annual Gross Income, such as moving expenses and 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. 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.

### **This Bill**

This bill would, under the PITL for taxable years beginning on or after January 1, 2020, and before January 1, 2025, allow an above-the-line deduction in an amount equal to the monetary contribution made by a qualified taxpayer during the taxable year to one or more accounts established pursuant to the California qualified tuition program on behalf of a beneficiary.

The deduction amount would be limited as follows:

- For a qualified taxpayer who is a head of household, a surviving spouse, or a married couple filing a joint return; \$10,000.
- For a qualified taxpayer filing a return other than described above; \$5,000.

“Monetary contribution” would mean cash contributions<sup>1</sup> to the California qualified tuition program, except for the following:

- Any amount transferred to the California qualified tuition program from a qualified tuition program established pursuant to IRC section 529.
- Any amount transferred from the credit of one beneficiary under the California qualified tuition program to the credit of another beneficiary under the California qualified tuition program.

“Qualified taxpayer” would mean an individual who, on behalf of a beneficiary, contributes money to a qualified tuition program for which the individual is the account owner.

“California qualified tuition program” would mean a qualified tuition program as defined in IRC section 529 and as established pursuant to the Golden State Scholarshare Trust Act.<sup>2</sup>

For the purposes of IRC section 529(c)(3), relating to distributions, amounts allowed as a deduction under this section would not be treated as investment in the contract in applying IRC section 72, relating to annuities.<sup>3</sup>

A qualified taxpayer would be required to maintain records that are adequate to substantiate any deduction allowed under this section, and would be required, upon request, to provide such records to the Franchise Tax Board (FTB).

The FTB could adopt regulations, standards, criteria, procedures, determinations, rules, notices, or guidelines necessary or appropriate to carry out the purposes of this section. This bill would exempt the FTB's standard, criteria, procedures, determinations, rules, notices, or guideline from the requirements of the Administrative Procedure Act.

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<sup>1</sup> Pursuant to IRC section 529(b)(2), relating to cash contributions.

<sup>2</sup> Commencing with Section 69980 of Chapter 2 of Part 42 of Division 5 of the Education Code.

<sup>3</sup> California conforms to IRC section 72, with modifications, as of the “specified date” of January 1, 2015.

In uncodified law, this bill would require the Scholarshare Investment Board to:

- Collect data on the amount of deductions allowed and income information for taxpayers allowed those deductions, for the taxable year, from the FTB when this data is finalized, but no later than April 1 of the second calendar year following the taxable year.
- Collect data on the total amount of contributions made to “Scholarshare”<sup>4</sup> accounts by March 1 of each calendar year that the deduction may be claimed on a tax return.
- Survey new and existing “Scholarshare” account owners to collect information about their motivation to do all of the following:
  - Open a “Scholarshare” account.
  - Contribute to a “Scholarshare” account.
  - Increase the frequency and amount of contributions to a “Scholarshare” account.
  - Refer a “Scholarshare” account to friends and family.
- Deliver a report to the Legislature,<sup>5</sup> submitted in compliance with Government Code section 9795, that would include, but not be limited to, prior year and cumulative baseline data and information described above, and the following performance indicators:
  - Number of deductions allowed by FTB.
  - Total dollar amount of deductions allowed by FTB.
  - Number of new “Scholarshare” accounts opened during the calendar year in which the deduction is in effect.

The bill's provisions would be repealed on December 1, 2025.

### **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.

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<sup>4</sup> This term refers to California's qualified tuition program (as described in IRC section 529). Also known as California's college savings plan and California's 529 plan.

<sup>5</sup> On or before July 31 of each calendar year after the year beginning January 1, 2019.

This bill defines a qualified taxpayer as an individual. However, the bill also states that a deduction is allowed for a qualified taxpayer who is a married couple (more than one person). For clarity and ease of administration, it is recommended that the bill be amended.

This bill would allow a qualified taxpayer to make a contribution to a Section 529 plan, and generate an above-the-line deduction even if the funds are immediately withdrawn, and used for a purpose other than “qualified higher education expenses” as specified in IRC section 529. If this is contrary to the author's intent, the author may wish to amend the bill to provide a recapture or disallowance provision.

The bill's reporting requirements include the undefined terms “amount of deductions allowed” and “income information for taxpayers allowed those deductions” making it unclear what information the FTB would be required to provide to the Scholarshare Investment Board. For clarity and ease of administration the bill should be amended to specify the deduction and income data the FTB is to provide. Additionally, absent corresponding amendments to the disclosure provisions allowing the FTB to disclose specified additional information to the Scholarshare Investment Board, such disclosure would remain barred.

### **Technical Considerations**

The bill includes reporting requirements in uncodified law. For ease of administration it is recommended that the bill include these requirements in the relevant section of the Revenue and Taxation Code.

### **Legislative History**

SB 1218 (Gaines, 2017/2018), would have allowed an itemized deduction for contributions made to a qualified tuition program. SB 1218 failed passage out of the Senate by the constitutional deadline.

AB 209 (Patterson, et al., 2015/2016), would have allowed an itemized deduction for contributions made to a qualified tuition program. AB 209 failed passage out of the Assembly by the constitutional deadline.

AB 2726 (McCarty, 2015/2016), would have allowed a credit for contributions made to a qualified tuition program. AB 2726 failed passage 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, business entity types, and tax laws.

*Illinois* has three qualified tuition programs: the College Illinois Prepaid Tuition Plan, the Bright Start College Savings Plan, and the Bright Directions College Savings Program and allows a deduction of up to \$20,000 per year for joint filers (per beneficiary) for contributions to these programs. *Illinois* requires an add-back to income for non-qualified expenses if previously subtracted from gross income, for individuals.

*Massachusetts* has two qualified tuition programs, the U Plan Prepaid Tuition Program and the U Fund Savings Plan. For tax years 2017 through tax year 2021, *Massachusetts* allows a deduction of up to \$2,000 for married filing joint taxpayers who put money into a prepaid tuition program or college savings account. The deduction is subject to recapture in the taxable years in which a distribution or a refund is made for a reason other than to pay qualified higher education expenses or the beneficiary's death, disability, or receipt of a scholarship.

*Michigan* has two qualified tuition programs, the Michigan Education Savings Program (MESP) for individuals and entities exempt under IRC section 501(c)(3), and the Michigan Education Trust (MET), which is a guaranteed tuition program. Taxpayers can deduct payments made under certain contracts of up to \$10,000 per taxable year for joint filers. Taxpayers must add to income a portion of refunds made when a contract is ended and beneficiaries do not attend college or universities.

*Minnesota* has one qualified tuition program, the Minnesota College Savings Plan. *Minnesota* allows the option of claiming either a tax credit or deduction for contributions to any state 529 plan. Only one tax benefit can be claimed in a given tax year. Taxpayers may deduct up to \$3,000 for a married couple filing jointly for contributions made to a qualified 529 account or opt for a non-refundable tax credit of half of the contribution amount up to \$500, subject to phase-out. For tax years after December 31, 2016, non-qualifying distributions may be subject to the Education Savings Account Recapture Tax, if the taxpayer previously claimed a contribution or subtraction.

*New York* has one qualified tuition program, the New York State College Choice Tuition Savings Program. *New York* allows a deduction of up to \$10,000 per year for joint filers for contributions to its qualified tuition program, and lacks an add-back for non-qualifying expenses.

### **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.

## Economic Impact

### Revenue Estimate

This bill would result in the following revenue loss:

Estimated Revenue Impact of AB 211 as Amended on April 8, 2019  
Assumed Enactment after June 30, 2019

(\$ in Millions)

<b>Fiscal Year</b>	<b>Revenue</b>
2019-2020	-\$18.0
2020-2021	-\$37.0
2021-2022	-\$43.0

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.

### Revenue Discussion

Based on IRC Section 529 College Savings Plan data from the College Savings Plan Network, there were approximately 300,000 California Scholarshare College Savings Plan accounts in 2017. It is estimated that approximately 90 percent, or 270,000, of accounts are held by California resident taxpayers, and the remaining 30,000 are held by non-resident taxpayers. The number of accounts is adjusted to reflect changes in the economy over time, resulting in an estimated 380,000 total accounts in 2020.

Based on TIAA-CREF Financial Services data, approximately 50 percent of account holders make regular annual contributions. This percentage rises to 58 percent in states with deductions or nonrefundable tax credits for contributions. This estimate assumes 60 percent, or 230,000, of the qualifying account holders would make regular contributions. In addition, it is assumed that 80 percent, or 180,000 taxpayers, would claim the deduction in the first year and 100 percent would claim the deduction each year thereafter. Assuming an average contribution of \$2,300 per account results in an estimated \$415 million in contribution deductions in taxable year 2020. This amount is then multiplied by an average tax rate of 7.3 percent, resulting in an estimated revenue loss of \$30 million in 2020.

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

### **Policy Concerns**

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

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