



Analysis of Amended Bill

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Sponsor:

Bill Number: SB 263

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Introduced February 12, 2019, &
Amended April 22, 2019

Attorney: Shane Hofeling

Related Bills: See Legislative
History

Subject: Federal Conformity – ABLE Programs and Small Business Accounting

Summary

This bill would do the following:

Provision No. 1: This provision would, under the Personal Income Tax Law (PITL) and the Corporation Tax Law (CTL), allow amounts from qualified tuition programs to be rolled over to Achieving a Better Life Experience (ABLE) accounts without penalty.

Provision No. 2: This provision would, under the PITL and the CTL, increase the ABLE contribution limitation amounts.

Provision No. 3: This provision would, under the CTL, expand the universe of taxpayers that may use the cash method of accounting.

Provision No. 4: This provision would, under the PITL, allow a savers tax credit for qualified taxpayers for qualified retirement savings contributions.

Summary of Amendments

The bill, as introduced on February 12, 2019, would allow amounts from qualified tuition programs to be rolled over to ABLE accounts without penalty, increase the ABLE contribution limitations, and would expand the corporations that could elect small business treatment.

The April 22, 2019, amendments added a provision to allow, in partial conformity with the federal savers tax credit, a credit for qualified retirement savings contributions to ABLE accounts.

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

Recommendation – No position.

Reason for the Bill

The reason for this bill is to encourage individuals with disabilities to save for the future, and to provide much needed relief for small businesses in California.

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, 2026.

Economic Impact – Summary Revenue Table (\$ in Millions)

| Fiscal Year | 2019-2020 | 2020-2021 | 2021-2022 |
|---|------------------|------------------|------------------|
| Provision No. 1: Qualified Tuition Program Rollovers to ABLE Programs | -\$0.03 | -\$0.06 | -\$0.08 |
| Provision No. 2: Increased Contributions to ABLE Programs | -\$0.03 | -\$0.05 | -\$0.08 |
| Provision No. 3: Small Business Accounting | -\$100.00 | -\$280.00 | -\$180.00 |
| Provision No. 4: Savers Tax Credit | -\$0.00 | -\$0.90 | -\$1.20 |
| Total \$ in Millions | -\$100.06 | -\$281.01 | -\$181.36 |

Provision No. 1: Qualified Tuition Program Rollovers to ABLE Programs

Federal/State Law

Existing state and federal laws provide for qualified tuition programs, also known as Internal Revenue Code (IRC) 529 accounts, as well as ABLE accounts, also known as IRC 529A accounts. Both are tax-favored savings programs. An IRC section 529 plan account is a tax-advantaged investment vehicle in the United States designed to encourage saving for the future higher education expenses of a designated beneficiary. An ABLE account is a tax-advantaged investment vehicle in the United States designed to encourage saving for the account beneficiary's qualified disability expenses.

Introduced February 12, 2019, and Amended April 22, 2019

Federal law, under the provisions of the Tax Cuts and Jobs Act (TCJA), temporarily allows amounts from an IRC 529 account to be rolled over to an ABLE account without penalty, provided that the ABLE account is owned by the designated beneficiary of that 529 account, or a member of such designated beneficiary's family. Such rolled-over amounts count towards the overall limitation on amounts that can be contributed to an ABLE account within a taxable year.

Current state law conforms to IRC sections 529 and 529A, as of the "specified date" of January 1, 2015, with modifications. California has not conformed to the modifications of IRC 529 and ABLE accounts made by the TCJA.

This Provision

This provision would, under the PITL and the CTL, for taxable years beginning on or after January 1, 2020, and before January 1, 2026, conform to the federal provisions allowing amounts from IRC 529 accounts to be rolled over to ABLE accounts without penalty.

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.

Because current state law conforms to IRC sections 529 and 529A as of the "specified date" of January 1, 2015, with modifications, in addition to nonconformity to the modifications made by the TCJA, neither has California conformed to the amendments made to IRC sections 529 and 529A by the Consolidated Appropriations Act of 2016 (Public Law 114-113). If the author's intention is to conform to existing federal law, this provision should be amended to incorporate Public Law 114-113 amendments as well.

Legislative History

AB 736 (Irwin, 2019/2020), similar to this provision, would allow amounts from qualified tuition programs to be rolled over to ABLE accounts without penalty. This bill is currently in the committee process.

Other States' Information

The states surveyed include *Florida, 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. A review of these states' laws found that all provide 529 college savings plans and ABLE programs in their state.

Florida, Massachusetts, Michigan, and New York generally conform to the federal treatment of 529 and ABLÉ accounts, and allow amounts from their state qualified tuition programs to be rolled over to their state ABLÉ accounts without penalty.

Illinois and Minnesota generally conform to the federal treatment of 529 and ABLÉ accounts, and allow amounts from their state qualified tuition programs to be rolled over to their state ABLÉ accounts without penalty, although tax-free rollovers are restricted to once per a 12-month period.

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:

Estimated Revenue Impact of SB 263 as Amended on April 22, 2019
Assumed Enactment after June 30, 2019

| Fiscal Year | Revenue |
|--------------------|----------------|
| 2019-2020 | -\$30,000 |
| 2020-2021 | -\$60,000 |
| 2021-2022 | -\$80,000 |

This analysis does not account for changes in employment, personal income, or gross state product that could result from this provision or for the net final payment method of accrual.

Revenue Discussion

This revenue estimate is based upon a proration of the Joint Committee on Taxation (JCT) estimate for amounts from 529 accounts to be rolled over to an ABLÉ account without penalty. In December 2018, the JCT estimated the federal revenue impact of the credit to be a loss of \$1 million in 2020. The estimated revenue loss to California would be \$50,000 in tax year 2020.

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

Provision No. 2: Increased Contributions to ABLE Programs

Federal/State Law

Existing federal and state laws allow contributions to an ABLE account for the qualified disability expenses of the designated beneficiary of the account. The general overall limitation on contributions is the per-donee annual gift tax exclusion, \$14,000 for 2017 and \$15,000 for 2018 and 2019. Contributions may be made by any person to an ABLE account, established for the purpose of meeting the qualified disability expenses of the designated beneficiary that is an eligible individual, as defined, of the ABLE account. Contributions to an ABLE account must be made in cash, are subject to specified limitations, and are not deductible.

Provisions of the TCJA increased the contribution limitation to ABLE accounts under certain circumstances. Under the provision, after the overall limitation on contributions is reached, an ABLE account's designated beneficiary may contribute an additional amount, up to the lesser of (a) the federal poverty line for a one-person household; or (b) the designated beneficiary's compensation for the taxable year.

Current state law conforms to federal law regarding ABLE accounts as of the "specified date" of January 1, 2015, with modifications. California has not conformed to the modifications of ABLE account contribution limitations made by the TCJA.

This Provision

This provision would, under the PITL and the CTL, for taxable years beginning on or after January 1, 2020, and before January 1, 2026, conform to the federal provisions allowing increased contributions from the ABLE account's designated beneficiary without penalty.

Implementation Considerations

The department has identified the following implementation concern. Department staff is available to work with the author's office to resolve this and other concerns that may be identified.

Because current state law conforms to IRC sections 529 and 529A as of the "specified date" of January 1, 2015, with modifications, in addition to nonconformity to the modifications made by the TCJA, neither has California conformed to the amendments made to IRC sections 529 and 529A by the Consolidated Appropriations Act of 2016 (Public Law 114-113). If the author's intention is to conform to existing federal law, this provision should be amended to incorporate Public Law 114-113 amendments as well.

Legislative History

AB 416 (Fong, 2019/2020) would allow an above-the-line tax deduction (a deduction when determining adjusted gross income) for amounts contributed to a CalABLE account. This bill is currently in the committee process.

AB 2039 (Fong, 2017/2018) would have allowed an above-the-line deduction for contributions to a CalABLE account. AB 2039 failed passage out of the Assembly by the constitutional deadline.

SB 1352 (Stone, 2017/2018) would have allowed a credit for contributions to a CalABLE account. SB 1352 failed passage out of the Senate by the constitutional deadline.

Other States' Information

The states surveyed include *Florida, 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. A review of these states' laws found that all have established ABLÉ programs in their state.

Florida, Illinois, Michigan, and New York have conformed to the increased ABLÉ account contribution limit allowed under the TCJA.

Massachusetts and Minnesota have not conformed to the increased ABLÉ account contribution limit allowed under the TCJA.

Fiscal Impact

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

Economic Impact

Revenue Estimate

This provision would result in the following revenue loss:

Estimated Revenue Impact of SB 263 as Amended on April 22, 2019
Assumed Enactment after June 30, 2019

| Fiscal Year | Revenue |
|-------------|-----------|
| 2019-2020 | -\$30,000 |
| 2020-2021 | -\$50,000 |
| 2021-2022 | -\$80,000 |

This analysis does not account for changes in employment, personal income, or gross state product that could result from this provision or for the net final payment method of accrual.

Revenue Discussion

This revenue estimate is based on a proration of the JCT estimate for increased contributions to ABLE accounts and to allow contributions to be eligible for the saver's credit. In December 2018, the JCT estimated the federal revenue impact of the contributions would be a loss of \$1 million in 2020. California does not conform to the saver's credit. After adjusting to remove the impact of the saver's credit, the net revenue loss to California would be \$50,000 in tax year 2020.

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

Provision No. 3: Small Business Accounting

Federal/State Law

Existing state and federal laws allow small businesses (other than tax shelters) the ability to apply the cash method of accounting. For federal purposes, small businesses with annual average gross receipts that do not exceed \$25 million (indexed for inflation for taxable years beginning after December 31, 2018) for the three prior taxable years are allowed to use the cash method. Under prior law, the threshold of the gross receipts test was \$5 million.

The exceptions from the required use of the accrual method for qualified personal service corporations and taxpayers other than C corporations are retained. Accordingly, qualified personal service corporations, partnerships without C corporation partners, S corporations, and other pass-through entities are allowed to use the cash method without regard to whether they meet the \$25 million gross receipts test, so long as the use of the method clearly reflects income.

California, under the PITL and the CTL, generally conforms to these federal rules as of the "specified date" of January 1, 2015. California has not conformed to the definition of a small business as expanded by the TCJA.

This Provision

This provision would, under the CTL, for taxable years beginning on or after January 1, 2020, conform to the federal provisions increasing the threshold of the small business gross receipts test from \$5 million to \$25 million.

Implementation Considerations

Implementing this provision would occur during the department's normal annual updates.

Legislative History

Research of California legislation history found no legislation similar to this provision of the bill.

Other States' Information

The states surveyed include *Florida, 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. A review of these states' laws found that generally all follow the federal provisions allowing the small business cash method of accounting.

Florida, Illinois, Michigan, and New York have conformed to the increased small business gross receipts test allowed under the TCJA.

Massachusetts and Minnesota have not conformed to the increased small business gross receipts test allowed under the TCJA.

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:

Estimated Revenue Impact of AB 263 as Amended April 22, 2019
Assumed Enactment after June 30, 2019

(\$ in Millions)

| Fiscal Year | Revenue |
|-------------|---------|
| 2019-2020 | -\$100 |
| 2020-2021 | -\$280 |
| 2021-2022 | -\$180 |

This analysis does not account for changes in employment, personal income, or gross state product that could result from this provision or for the net final payment method of accrual.

Revenue Discussion

This revenue estimate is based on a proration of the JCT federal tax expenditure estimate for Simplified Accounting for Small Business. In December 2017, the JCT estimated the federal revenue loss from the change in accounting method to be \$7.6 billion in the first year. The corresponding loss for California is estimated to be \$250 million in taxable year 2020.

To determine California's share of the federal loss, federally reported data was used to calculate that 8 percent of nationally reported income was from California, then federal and state tax rates were analyzed to estimate a federal to state tax adjustment of 40 percent. These values were combined to estimate California's loss. The tax year estimates are converted to fiscal year revenue estimates and rounded to arrive at the amounts reflected in the above table.

Provision No. 4: Savers Tax Credit

Federal/State Law

Existing federal law, IRC section 25B, provides a nonrefundable, savers tax credit for eligible taxpayers for qualified retirement savings contributions. The maximum annual contribution eligible for the credit is \$2,000 per individual. The credit rate depends on the taxpayer's adjusted gross income (AGI), indexed for inflation, and varies from zero to fifty percent. As the taxpayer's AGI increases, the credit rate decreases. The federal credit is in addition to any deduction or exclusion that would otherwise apply with respect to the contribution. The credit offsets alternative minimum tax liability as well as regular tax liability, and is available to individuals who are 18 years old or older, other than individuals who are full-time students or claimed as a dependent on another taxpayer's return.

Qualified retirement savings contributions consist of:

- 1) Elective deferrals to an IRC section 401(k) plan, an IRC section 403(b) plan, a governmental IRC section 457 plan, a SIMPLE plan, or a SARSEP.
- 2) Contributions to a traditional or Roth IRA.
- 3) Voluntary after-tax employee contributions to a qualified retirement plan or IRC section 403(b) plan.

An individual's contribution generally cannot exceed the lesser of an annual dollar amount (for example, in 2018, \$5,500 in the case of an IRA of an individual under age 50) or the individual's compensation that is includible in income. In the case of IRA contributions of a married couple, the combined includible compensation of both spouses may be taken into account.

The amount of any contribution eligible for the credit is reduced by distributions received by the taxpayer from any retirement plan to which eligible contributions can be made during the taxable year for which the credit is claimed, during the two taxable years prior to the year for which the credit is claimed, and during the period after the end of the taxable year for which the credit is claimed and prior to the due date, including extensions, for filing the taxpayer's return for the year. Distributions that are rolled over to another retirement plan do not affect the credit.

The federal savers tax credit related to any ABLE contribution applies to taxable years beginning after December 22, 2017, and ends for contributions made before January 1, 2026.

California does not conform to the saver's tax credit, and lacks a comparable credit.

This Provision

This provision would, under the PITL, for taxable years beginning on or after January 1, 2020, and before January 1, 2026, partially conform to the federal savers tax credit, and allow a savers tax credit for qualified retirement savings contributions made to their ABLE account.

For the taxable year, the credit amount is determined in accordance with of the IRC section 25B, as modified, relating to elective deferrals and IRA contributions by certain individuals, as amended by the TCJA, except as follows:

- 1) The inflation adjustment is modified by substituting "2021" in lieu of "2006."
- 2) The cost-of-living adjustment is modified by substituting "calendar year 2020" for "calendar year 2005."
- 3) The qualified retirement savings contributions section does not apply. Instead "qualified savings contributions" means the amount of contributions made before January 1, 2026, by an individual to their ABLE account, within the meaning of IRC section 529A, relating to the qualified ABLE programs, as amended by the TCJA, of which the individual is the designated beneficiary.

This provision would remain in effect until December 1, 2026, and as of that date is repealed.

Implementation Considerations

The department has identified the following implementation concern. Department staff is available to work with the author's office to resolve this and other concerns that may be identified.

Because current state law conforms to IRC sections 529 and 529A as of the "specified date" of January 1, 2015, with modifications, in addition to nonconformity to the modifications made by the TCJA, neither has California conformed to the

amendments made to IRC sections 529 and 529A by the Consolidated Appropriations Act of 2016 (Public Law 114-113). If the author's intention is to conform to existing federal law, this provision should be amended to incorporate Public Law 114-113 amendments as well.

Legislative History

Research of California legislation history found no legislation similar to this provision of the bill.

Other States' Information

The states surveyed include *Florida, 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.

The state of *Massachusetts* allows a state savers tax credit.

Florida, Illinois, Michigan, Minnesota, and New York do not offer a state savers tax credit.

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:

Estimated Revenue Impact of SB 263 as Amended on April 22, 2019
Assumed Enactment after June 30, 2019

(\$ in Millions)

| Fiscal Year | Revenue |
|--------------------|----------------|
| 2019-2020 | -\$0.0 |
| 2020-2021 | -\$0.9 |
| 2021-2022 | -\$1.2 |

This analysis does not account for changes in employment, personal income, or gross state product that could result from this provision or for the net final payment method of accrual.

Revenue Discussion

The CalABLE Savings Plan was made available to the public on December 18, 2018. As a result, an actual full year's data is not currently available. Based on the California Treasurer's CalABLE projections, it is estimated that \$45 million in qualified contributions would be made to CalABLE accounts in 2020. The saver's credit is allowed only to beneficiaries that contribute to their own ABL accounts. It is assumed 5 percent, or \$2.2 million in contributions would qualify for the credit. This estimate assumes the beneficiaries would meet the adjusted gross income limit to qualify for the 50 percent credit, or \$1.1 million. It is assumed that 80 percent, or \$900,000, would be earned by taxpayers who have a tax liability to offset with the credit, and the remaining credit would go unused due to the lack of carryover provision. It is assumed that nonresident taxpayers would qualify for this credit; however, the amount generated and claimed would be minor.

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

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