STATE OF CALIFORNIA
Franchise Tax Board

Analysis of Original Bill

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Subject: Private School Tax Credit

Summary

This bill, under the Personal Income Tax Law (PITL), would create a private school tax credit, and under the Education Code (EC) would establish the Cal Grant K-12 Award, and enact and repeal numerous other provisions related to elementary and secondary education.

This analysis only addresses the provisions of the bill that would impact the department's programs and operations.

Recommendation – No position.

Reason for the Bill

The reason for this bill is to provide financial relief for taxpayer's whose children attend private school, as specified.

Effective/Operative Date

This bill would be effective January 1, 2020, and would be specifically operative for taxable years beginning on or after January 1, 2019, and before January 1, 2024.

Federal/State Law

Federal law provides tax-exempt status to qualified tuition programs referred to as "529 Plans." Distributions from a qualified tuition program are excludable from federal tax if used for the beneficiary's qualified higher education expenses. Federal law provides that "qualified higher education expenses" includes expenses for tuition in connection with enrollment or attendance at an elementary or secondary public, private, or religious school for distributions made after December 31, 2017.[1] The amount of cash distributions from all 529 plans with respect to a beneficiary during any tax year when combined, is limited to $10,000 of such expenses.[2]

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 has yet to conform to the expansion of qualified higher education expenses to elementary or secondary tuition.

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 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.

Under Revenue and Taxation Code (R&TC) section 41, legislation that would create a new tax credit is required to include specific goals, purposes, objectives, and performance measures to allow the Legislature to evaluate the credit's effectiveness.

This Bill

For each taxable year beginning on or after January 1, 2019, and before January 1, 2024, this bill, under the PITL, would create a credit in an amount equal to the costs paid or incurred during the taxable year by a taxpayer for the qualified tuition expenses of a qualified dependent.

This bill would define the following terms and phrases:

- "Eligible educational institution" means a private kindergarten, elementary, or secondary school.
- "Qualified dependent" means any dependent of a taxpayer who is attending an eligible educational institution.
- "Qualified tuition expenses" includes all of the following:
    - Tuition, fees, books, supplies, and equipment required for the enrollment or attendance of a qualified dependent at an eligible educational institution.

[1] Internal Revenue Code (IRC) section 529(c), as amended by the federal Tax Cuts and Jobs Act (Public Law (PL) 115-97, Act section 11032(a)(1), December 22, 2017.
[2] IRC section 529(e)(3)(A), as amended by P.L. 115-97, Act section 11032(a)(2).]

- Expenses for special needs services in the case of a special needs qualified dependent that are incurred in connection with the enrollment or attendance.
- Expenses for the purchase of computer or peripheral equipment, as defined in IRC section 168(i)(2)(B), relating to computer or peripheral equipment defined, computer software, as defined in IRC section 197(e)(3)(B), relating to computer software defined, or internet access and related services, if the equipment, software, or services are to be used primarily by the qualified dependent during any of the years the qualified dependent is enrolled at an eligible educational institution. These expenses shall not include expenses for computer software designed for sports, games, or hobbies unless the software is predominantly educational in nature.

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

This bill expresses Legislative intent to comply with R&TC section 41.

The credit would be repealed by its own terms on December 1, 2024.

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 and phrases that are undefined, i.e., "private kindergarten, elementary, or secondary school," "dependent," "tuition, fees, books, supplies, and equipment required," "special needs services," "special needs qualified dependent," "in connection with the enrollment or attendance," "related services," "computer software designed for sports, games, or hobbies," and "predominantly educational in nature." It is recommended that these terms and phrases be defined by reference to an existing statutory definition. For example, the term "dependent" could be defined by reference to Revenue and Taxation Code (R&TC) section 17056. The absence of 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.

For consistency of terminology within the R&TC, the term "costs" should be replaced with "amounts."

Legislative History

Research of California legislation found no legislation similar to the provisions of this 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.

*Florida l*acks a personal income tax; however, *Florida* offers a scholarship program allowing students with disabilities to attend a private school of choice. The scholarship amount is generally equal to what a public school would receive for each participating student.

Illinois allows a nonrefundable credit equal to 25 percent of qualified education expenses paid for students enrolled in public or private schools from Kindergarten through 12th grade. The maximum credit is $750.

*Massachusetts l*acks a credit comparable to the one this bill would create. However, *Massachusetts* conforms to federal law allowing tax-free distributions from 529 Plans for private tuition expenses for Kindergarten through Grade 12.

Minnesota allows a refundable K-12 Education Credit equal to 75 percent of the amount paid for education-related expenses for a qualifying child in Kindergarten through grade 12. The credit is phased out for household income from over $39,500.

New York lacks a credit comparable to the one this bill would create.

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 As Introduced on February 21, 2019
Assumed Enactment after June 30, 2019

($ in Millions)

Fiscal Year	Revenue
2019-2020	-$9,500
2020-2021	-$8,000
2021-2022	-$8,000

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 data from US Census Bureau, it is estimated there would be 565,000 qualified dependents in 2019. Based on private school data, it is assumed the average cost of qualified tuition expenses would be $15,200, resulting in $8.6 billion in expenses. The credit is allowed at an equal amount to costs paid or incurred during the taxable year, or $8.6 billion, including the non-resident adjustment.

It is estimated that 95 percent, or $8 billion, would be earned by taxpayers who have a tax liability to offset with the credit. Of that amount 65 percent, or $5.2 billion, would claim the credit in the year generated and the remaining 35 percent would be claimed in the subsequent years. This results in an estimated credit used of $5.2 billion in the 2019 taxable year.

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

Policy Concerns

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

The credit would be allowed for qualified tuition expenses paid or incurred either inside or outside California.

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-project or per-taxpayer basis. This bill would provide a 100 percent credit which would be unprecedented.

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