



Bill Analysis

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Sponsor: California State
Treasurer, Fiona Ma

Bill Number: AB 340

Amended: March 29, 2021

Related Bills: See Legislative
History

SUBJECT

Conformity to Expanded Definition of Higher Education Expenses

SUMMARY

This bill would partially conform the existing Golden State Scholarshare Trust for college savings to the federal qualified tuition program (QTP) definition of qualified higher education expenses by adding apprenticeship program expenses, and principal and interest of qualified education loan expenses.

RECOMMENDATION

No position.

SUMMARY OF AMENDMENTS

The March 29, 2021, amendments added provisions in the Revenue and Taxation Code (RTC) relating to the expanded definition of higher education expenses.

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

REASON FOR THE BILL

The reason for this bill is to partially conform to federal tax changes for California families who have QTP plans.

ANALYSIS

The Golden State Scholarshare Trust is a college tuition prepayment program created and sponsored by the State of California. The Scholarshare Investment Board enters into agreements with participants for the advance payment of qualified higher education expenses for a beneficiary to attend an institution of higher education.

The Golden State Scholarshare Trust is established and maintained as a QTP under Internal Revenue Code (IRC) section 529. Other states and certain types of organizations also have QTP programs under IRC section 529.

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This bill would add expenses associated with participation in a registered apprenticeship program and payment of principal or interest of a qualified education loan to the definition of "qualified higher education expenses" in the California Education Code (EDC) as of January 1, 2022, (the effective date of the bill).

In addition, for taxable years beginning on or after January 1, 2021, this bill adds a provision to the RTC that partially conforms to Further Consolidated Appropriations Act (FCAA) (PL 116-94), Section 302. Specifically, this bill would add expenses associated with participation in a registered apprenticeship program and payment of principal or interest of a qualified education loan to the definition of "qualified higher education expenses" for purposes of the RTC's partial conformity to the QTP distributions provisions under IRC section 529. The payments of principal or interest of qualified education loans would be allowed as "qualified higher education expenses" if made to a beneficiary or a beneficiary's sibling, and would be subject to a lifetime limit of \$10,000 separately for both the beneficiary and sibling.

Also, under the RTC for taxable years beginning on or after January 1, 2021, this bill would disallow the deduction available on qualified education loan interest to the extent such interest is paid from a tax-free distribution of a QTP.

Effective/Operative Dates

This bill would be effective on January 1, 2022, and operative on the same date for the EDC provisions. The bill's RTC provisions would be specifically operative for taxable years beginning on or after January 1, 2021.

Federal/State Law

Federal Law

Qualified Tuition Program or QTP

A QTP (also referred to as a 529 plan) is a program established and maintained by a State or agency or instrumentality thereof, or by one or more eligible educational institutions, which satisfies certain requirements and under which a person may purchase tuition credits or certificates on behalf of a designated beneficiary that entitle the beneficiary to the waiver or payment of qualified higher education expenses of the beneficiary (a "prepaid tuition program"). IRC section 529 provides specified income tax and transfer tax rules for the treatment of accounts and contracts established under QTPs.

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Distributions for the purpose of meeting the designated beneficiary's higher education expenses are generally not subject to tax. The term qualified higher education expenses means:

- Tuition, fees, books, supplies, and equipment required for the enrollment or attendance of a designated beneficiary at an eligible educational institution,
- Expenses for special needs services in the case of a special needs beneficiary that are incurred in connection with such enrollment or attendance,
- Room and board for students who are enrolled at least half-time,
- The purchase of any computer technology or equipment, or Internet access or related services, if such technology or services are to be used primarily by the beneficiary during any of the years a beneficiary is enrolled at an eligible institution,
- Fees, books, supplies, and equipment required for the participation of a designated beneficiary in an apprenticeship program,
- Distributions used to make payments on principal or interest of a qualified education loan of the beneficiary or a sibling, that are subject to a lifetime limit of \$10,000 separately for both the beneficiary and sibling, and
- For distributions made after December 31, 2017, up to \$10,000 in aggregate distributions to be used for tuition expenses for enrollment or attendance at an elementary or secondary public, private, or religious school.

Contributions to a QTP must be made in cash. IRC section 529 does not impose a specific dollar limit on the amount of contributions, account balances, or prepaid tuition benefits relating to a qualified tuition account.

Contributions are not tax deductible for federal income tax purposes, and earnings amounts in the account accumulate on a tax-free basis.

Deduction for Interest on Education Loans

Certain individuals who have paid interest on qualified education loans may claim an above-the-line deduction for such interest expenses, subject to a maximum annual deduction limit of \$2,500. For 2020, the deduction is phased out ratably for taxpayers with modified adjusted gross income (AGI) between \$70,000 and \$85,000 (\$140,000 and \$170,000 for married taxpayers filing a joint return). The income phase-out ranges are indexed for inflation.

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A qualified education loan generally is defined as any indebtedness incurred solely to pay for the costs of attendance (including room and board) of the taxpayer, the taxpayer's spouse, or any dependent of the taxpayer as of the time the indebtedness was incurred in attending on at least a half-time basis (1) eligible educational institutions, or (2) institutions conducting internship or residency programs leading to a degree or certificate from an institution of higher education, a hospital, or a health care facility conducting postgraduate training.

Interest from a qualified education loan is not deductible to the extent it is paid from a tax-free distribution of a QTP.

State Law

California's Personal Income Tax Law (PITL) partially conforms to the federal rules related to QTPs under IRC section 529, and the student loan interest deduction under IRC section 221 as of the "specified date" of January 1, 2015, but does not conform to:

1. The definition of "qualified higher education expenses" for:
 - a. QTP distributions for elementary and secondary education with a maximum distribution amount of \$10,000,
 - b. QTP distributions for fees, books, supplies, and equipment required for the participation of a designated beneficiary in an apprenticeship program,
 - c. QTP distributions of amounts used to make payments on principal or interest of a qualified education loan, and
2. The limitation on the deductibility of qualified education loan interest relating to QTP distributions.

As a result, under California law, QTP distributions in item 1 above, are includable in California taxable income and are subject to the 2.5 percent premature distribution penalty. In addition, the student loan interest deduction in item 2 above is not limited by QTP distributions that are used to pay interest on student loans.

Implementation Considerations

The amendment to subdivision (l) of section 69980 of the EDC would be operative on January 1, 2022, while the amendments to the RTC sections in this bill have specific operative dates of January 1, 2021. It is recommended that the bill be amended to include similar operative date language in the EDC.

Technical Considerations

For consistency with the federal FCAA paragraph title, replace "deductions for student loan interest" with "coordination with deduction for student loan interest" in the amendment to RTC section 17201.7.

Policy Considerations

None noted.

LEGISLATIVE HISTORY

AB 91 (Chapter 39, Statutes of 2019) made numerous changes to the PITL, including conformity to several provisions relating to QTP accounts and distributions, while specifically not conforming to the addition of QTP distributions for elementary and secondary education with a maximum distribution amount of \$10,000, to the definition of qualified higher education expenses.

FISCAL IMPACT

This bill would not significantly impact the department's costs.

ECONOMIC IMPACT

Revenue Estimate

This bill would result in the following revenue loss:

Estimated Revenue Impact of AB 340 as Amended on March 29, 2021
Assumed Enactment after June 30, 2021

(\$ in Millions)

Fiscal Year	Revenue
2021-2022	-\$1.4
2022-2023	-\$0.9
2023-2024	-\$1.0

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

This estimate is based upon the proration of the Joint Committee on Taxation (JCT) federal tax estimate on the FCAA for Expansion of Section 529 Plans. The JCT estimated the expansion would result in a revenue loss of \$19 million in the 2021 taxable year. It is estimated the corresponding revenue loss to California would be \$1 million in the 2021 taxable year.

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

LEGAL IMPACT

None noted.

APPOINTMENTS

None noted.

SUPPORT/OPPOSITION

Support

American Federation of State, County and Municipal Employees, AFL-CIO
California State Treasurer, Fiona Ma (sponsor)

Opposition

None noted.

ARGUMENTS

To be determined.

LEGISLATIVE CONTACT

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