



Bill Analysis

Author: Ta

Sponsor:

Bill Number: AB 1026

Related Bills: See Legislative
History

Introduced: February 15, 2023

SUBJECT

Qualified Tuition Program Deduction

SUMMARY

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

RECOMMENDATION

No position.

SUMMARY OF AMENDMENTS

Not applicable.

REASON FOR THE BILL

The reason for the bill is to incentivize Californians to open and contribute to a California qualified tuition program, for future higher education expenses, to encourage Californians to pursue higher education and reduce the amount of student debt.

ANALYSIS

This bill would, under the PITL, for taxable years beginning on or after January 1 of a year subsequent to an appropriation being made in the annual Budget Act or other statute to administer the deduction, and before January 1, 2028, allow an above-the-line deduction for monetary contributions 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.

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The deduction would be limited to:

- For a qualified taxpayer who is a head of household, a surviving spouse, or a married couple filing a joint return, \$2,000 per beneficiary.
- For a qualified taxpayer filing a return other than described above, \$1,000 per beneficiary.

The bill would define the following terms:

- 1) "Monetary contribution" means cash contributions to the California qualified tuition program, except for the following:
 - Any amount transferred to the California qualified tuition program from another California qualified tuition program.
 - 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.
- 2) "Qualified taxpayer" means an individual, or a married couple if filing jointly, who, on behalf of a beneficiary, contributes money to a qualified tuition program for which the individual, or spouse if a married couple filing jointly, is the account owner and whose adjusted gross income (AGI) does not exceed the following:
 - For a qualified taxpayer who is a head of household, a surviving spouse, or a married couple filing a joint return, \$200,000.
 - For a qualified taxpayer filing a return other than described above, \$100,000.
 - For each taxable year beginning on or after January 1, 2025, the Franchise Tax Board (FTB) would annually be required to adjust for inflation the preceding taxable year's AGI limits in the same manner as the recomputation of the state income tax brackets.
- 3) "California qualified tuition program" means a qualified tuition program as defined in Internal Revenue Code (IRC) section 529 and as established pursuant to the Golden State Scholarshare Trust Act of the Education Code.
- 4) "Qualified higher education expenses" would mean qualified higher education expenses, as defined in IRC Section 529(e)(3).

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This bill would require the following related to distributions:

- Distributions in excess of qualified higher educational expenses would be added back to the taxpayer's gross income in the year of the distribution. This is required to the extent that the distribution is attributable to amounts that were allowed as a deduction that reduced the taxpayer's gross income for that taxable year during taxable years beginning on or after January 1, 2024, and before January 1, 2028. However, this add-back provision would not apply to any portion of the distribution in excess of qualified education expenses transferred to another California qualified tuition program within 60 days of the distribution.
- 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 an investment in the contract in applying IRC section 72, relating to annuities.

A qualified taxpayer would be required to maintain records that are adequate to substantiate any deduction allowed, and would be required, upon request, to provide such records to the FTB.

The FTB would be allowed to adopt necessary or appropriate regulations in order to implement this bill. In addition, the Administrative Procedure Act of the Government Code would not apply to any standard, criteria, procedures, determinations, rules, notices, or guidelines issued by the FTB in relation to this bill.

The provisions of this bill related to the allowance of a deduction would be repealed by its own terms on December 1, 2028.

The FTB would be required to provide information on the amount of deductions allowed and income information for taxpayers allowed those deductions, for the taxable year, to the Scholarshare Investment Board, upon request. The FTB would be required to provide the information by April 1 of the second calendar year following the taxable year the deduction is reported.

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 of a year subsequent to an appropriation being made in the annual Budget Act or other statute for the purposes of administering this deduction, and before January 1, 2028.

Federal/State Law

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

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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 is generally 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.

Lastly, recent federal legislation, the Federal SECURE 2.0 Act of 2022 (P.L. 117-328) provides that 529 plans, maintained for at least 15 years, may be distributed to a Roth IRA without a tax or penalty. Among other requirements, the distribution is also limited to an aggregate of \$35,000 in the current and prior taxable years. An amount distributed from a 529 plan to a Roth IRA would be treated in the same manner as the earnings and contributions of a Roth IRA. California does not conform to this recent federal law change.

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 AGI, 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.

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Implementation Considerations

The tax provisions specify that distributions in excess of qualified higher educational expenses would be added back to the taxpayer's gross income in the year of the distribution. This provision would apply to taxable years beginning on or after January 1, 2024. Based on the appropriation language, this provision could not impact tax year 2024.

Technical Considerations

None noted.

Policy Considerations

This bill would be operative for a year subsequent to an appropriation. Once an appropriation is approved, the deduction would be ongoing since the appropriation is not required annually, nor is the deduction turned off for years without an appropriation.

LEGISLATIVE HISTORY

SB 1374 (Borgeas 2021/2022), substantially similar to this bill, would have allowed an above-the-line deduction for contributions made to a qualified tuition program. SB 1374 was vetoed by the governor whose veto message stated in part: "While I appreciate the intent to incentivize Californians to save for higher education expenses, ScholarShare already has significant tax advantages. An additional tax deduction would largely benefit higher-income families that have tax liability and enough disposable income to contribute."

AB 211 (Calderon, et al., 2019/2020), substantially similar to this bill, would have allowed an above-the-line deduction for contributions made to a qualified tuition program. AB 211 was vetoed by the governor whose veto message stated in part: "While I appreciate the Legislature's intent, a careful balancing of the benefits of the proposed tax deduction in relation to the revenue losses, approximately \$13 million, would be better addressed through the annual budget process."

SB 1218 (Gaines, 2017/2018), would have allowed an itemized deduction for contributions made to a qualified tuition program. SB 1218 did not pass out of the Senate by the constitutional deadline.

PROGRAM BACKGROUND

None noted.

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FISCAL IMPACT

The department’s costs to implement this bill have yet to be determined. As the bill continues to move 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 1026 as Introduced February 15, 2023
Assumed Enactment after June 30, 2023

(\$ in Millions)

Fiscal Year	Revenue
2023-2024	-\$3.1
2024-2025	-\$5.7
2025-2026	-\$6.3

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.

LEGAL IMPACT

None noted.

APPOINTMENTS

None noted.

SUPPORT/OPPOSITION

To be determined.

ARGUMENTS

To be determined

LEGISLATIVE CONTACT

FTBLegislativeServices@ftb.ca.gov