



Bill Analysis

Author: Connolly

Sponsor:

Bill Number: AB 1589

Related Bills: See Legislative
History

Amended: April 11, 2023

SUBJECT

Qualified Tuition Program Deduction

SUMMARY

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

RECOMMENDATION

No position.

SUMMARY OF AMENDMENTS

The April 11, 2023, amendments added deduction limits per beneficiary, adjusted gross income thresholds, and reporting requirements.

REASON FOR THE BILL

The reason for the bill is to incentivize Californians to open and contribute to a California qualified tuition program.

ANALYSIS

This bill would, under the PITL, for taxable years beginning on or after January 1, 2023, 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.

The deduction would be limited to \$5,000 per beneficiary, per taxable year.

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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 taxpayer, 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, \$150,000.
 - For a qualified taxpayer filing a return other than described above, \$75,000
- 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).

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, 2023, 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.

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This bill would require the Franchise Tax Board (FTB) to report annually on the number of taxpayers whom both made a deduction and qualified for a program they did not qualify for previously. This report would be due by July 1, 2024, and annually thereafter.

The provisions of this bill related to the allowance of a deduction would be repealed on December 1, 2028.

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, 2023, and before January 1, 2028.

Federal/State Law

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 is generally subject to income tax and an additional 10% 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.

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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% tax on excess distributions to instead be an additional tax of 2.5% 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.

Implementation Considerations

The FTB is required to report on the number of taxpayers that both took the deduction and qualified for a program for which they did not qualify previously. FTB would not have information about a taxpayer’s eligibility for other programs. It is recommended that the author amend the requirement to have FTB report on the number of taxpayers that report the deduction.

Additionally, if the author’s intent is to be able to review a report that contains complete information for the 2023 taxable year, it is recommended that the reporting due date be extended to July of 2025.

Technical Considerations

Throughout Section 17206.2(b)(2), “individual” and “taxpayer” are used interchangeably; however, these terms have different meanings under the Revenue and Taxation Code. For consistency in terminology, the author may consider replacing “taxpayer” with “individual”.

Policy Considerations

None noted.

LEGISLATIVE HISTORY

AB 1026 (Ta, 2023/2024), similar to this bill, would allow an above-the-line deduction of up to \$1,000 or \$2,000, as applicable, for contributions made to a qualified tuition program. This bill is currently in the committee process.

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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.

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 1589 as Amended April 11, 2023
 Assumed Enactment after June 30, 2023

(\$ in Millions)

Fiscal Year	Revenue
2023-2024	-\$6.5
2024-2025	-\$4.7
2025-2026	-\$5.2

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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

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