STATE OF CALIFORNIA
Franchise Tax Board

Bill Analysis

Author: Wallis

Sponsor:

Bill Number: AB 629

Related Bills: See Legislative History

Amended: April 25, 2023

SUBJECT

Gross Income Exclusion Golden State ScholarShare Trust

SUMMARY

This bill would exclude from gross income a distribution from a qualified tuition program (QTP) to a Roth IRA.

RECOMMENDATION

No position.

SUMMARY OF AMENDMENTS

The April 25, 2023, amendments changed the operative date, added a sunset date, made technical changes under the Golden State ScholarShare Trust Act, amended the Revenue and Taxation Code (RTC) section related to qualified state tuition programs, and added Section 41 requirements.

The April 25, 2023, amendments resolved the implementation and technical considerations discussed in the Franchise Tax Board's (FTB's) analysis of the bill as introduced on February 9, 2023.

REASON FOR THE BILL

The reason for the bill is to provide conformity to the federal law which brings tax relief and ease of return preparation for taxpayers who transfer funds from a QTP to a Roth IRA.

ANALYSIS

For distributions made during taxable years beginning on or after January 1, 2024, and before January 1, 2029, this bill, under the Personal Income Tax Law (PITL), would conform to provisions of the Consolidated Appropriations Act (CAA), 2023 (P.L. 117-328) related to rollover distributions from certain QTP accounts to Roth IRAs. Specifically, this bill would allow a taxpayer to exclude from gross income a rollover distribution, up to $35,000, from a QTP that was maintained for 15 years to a Roth IRA.

This bill would require the officer or employee of the QTP to provide to the trustee of the Roth IRA that the distribution was made to with a copy of the report that includes information about the contributions, distributions, and earnings of the QTP. The report would be required to be filed at the time and manner prescribed by the FTB.

In compliance with RTC section 41, this bill would provide that the performance indicators for the Legislature is the number of taxpayers that transfer funds from a QTP to a Roth IRA and the amount of additional savings added to the Golden State ScholarShare Trust accounts and qualified tuition programs.

Effective/Operative Date

As a tax levy, this bill would be effective immediately upon enactment and specifically operative with respect to distributions made during taxable years beginning on or after January 1, 2024, and before January 1, 2029.

Federal/State Law

Federal Law

IRC section 529 (Section 529 Plan) provides tax-exempt status to QTPs.

Contributions to a QTP 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 QTP are excludable from federal tax if used for the beneficiary's qualified higher education expenses. If a distribution from a QTP exceeds the qualified higher education expenses incurred for the beneficiary, the portion of the excess that is treated as earnings generally is subject to income tax and an additional 10-percent tax. Amounts in a QTP may be rolled over to another QTP.

For purposes of receiving a distribution from a QTP that qualifies for favorable tax treatment under the IRC, expenses mean qualified higher education expenses, qualified elementary and secondary education expenses, and expenses for special needs services in the case of a special needs beneficiary that are incurred in connection with such enrollment or attendance.

Beginning in 2024, a rollover from QTPs that have been maintained for 15 years can be distributed to a Roth IRA without a tax or penalty. The transfer must be trustee to trustee, cannot exceed the aggregate amount contributed and earnings to the QTP more than five years before the distribution, and is limited to an aggregate of $35,000 in the current and prior taxable years. An amount distributed from a QTP to a Roth IRA would be treated in the same manner as the earnings and contributions of a Roth IRA.

IRC 408A provides the tax treatment of Roth IRAs, including the limit on contributions.

State Law

California's QTP is the Golden State ScholarShare College Savings Trust. The trust was created in 1997 and is administered by the ScholarShare Investment Board.

Under the PITL, California automatically conforms to IRC 408A, relating to Roth IRAs. California generally conforms by reference to the federal rules related to qualified state tuition program rules under IRC section 529 as of the specified date of January 1, 2015. As a result, the IRC Section 529 modification does not automatically apply under California law. The distribution from the Golden State ScholarShare Trust 529 plan or qualified state tuition programs to a Roth IRA would be includable in California taxable income and subject to 2.5 percent premature distribution penalty.

Implementation Considerations

None noted.

Technical Considerations

None noted.

Policy Considerations

None noted.

LEGISLATIVE HISTORY

AB 1026 (Ta, 2023/2024) would allow a qualified taxpayer a deduction from gross income for contributions made to a California QTP. AB 1026 has been referred to the Assembly Revenue and Taxation Committee.

AB 340 (Ward, Chapter 557, Statutes of 2021) conforms the existing Golden State ScholarShare Trust for college savings to the federal QTP definition of qualified higher education expenses by adding apprenticeship program expenses, and principal and interest of qualified education loan expenses.

AB 211 (Calderon, et al., 2019/2020), would have allowed 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 QTP on behalf of a beneficiary. 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."

AB 350 (Choi, 2019/2020) would have allowed a deduction, under the PITL, for amounts contributed by a qualified taxpayer to a QTP. AB 350 did not pass out of the Assembly Revenue and Taxation Committee by the constitutional deadline.

SB 1374 (Borgeas, 2021/2022) substantially similar to AB 211, would have allowed a qualified taxpayer a deduction from gross income for contributions made to a California QTP. 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."

SB 1218 (Gaines, 2017/2018), substantially similar to AB 350, would have allowed a deduction for contributions made to a QTP. SB 1218 did not pass out of the Senate Committee on Appropriations by the constitutional deadline.

PROGRAM BACKGROUND

None noted.

FISCAL IMPACT

The department's costs to implement this bill have not been determined, but staff anticipates costs would be minor.

ECONOMIC IMPACT

Revenue Estimate

This bill would result in the following revenue loss:

Estimated Revenue Impact of AB 629 as Amended April 25, 2023
Assumed Enactment after June 30, 2023

($ in Millions)

Fiscal Year	**Revenue**
2023-2024	-$4.6
2024-2025	-$6.8
2025-2026	-$8.1

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 on a proration of the Joint Committee on Taxation (JCT) federal estimate for the inclusion of special distribution rules from long-term QTPs to Roth IRAs. In December 2022, the JCT estimated the federal revenue impact of the exclusion to be a loss of $85 million in federal fiscal year 2023-24. The corresponding loss to California is estimated to be $4.6 million for fiscal year 2023-2024.

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

As per the Assembly Revenue and Taxation Committee analysis dated April 28, 2023, there is no support or opposition on file.

ARGUMENTS

As per the same analysis, there are no proponents or opponents of this bill on file.

LEGISLATIVE CONTACT

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