STATE OF CALIFORNIA
Franchise Tax Board

Bill Analysis

Author: Grove

Sponsor:

Bill Number: SB 64

Related Bills: See Legislative History

Introduced January 9 and Amended February 27, 2025

SUBJECT

School Choice Flex Account Act of 2025

SUMMARY

This bill, under the Education Code (EDC) would create the School Choice Flex Account Act of 2025. This act would create a state-funded trust under which parents and guardians can request that an account be established for their children for tuition and expenses associated with education at an eligible school, as defined. Under the Personal Income Tax Law (PITL), this bill, for taxable years beginning on or after January 1, 2027, would provide a gross income exclusion for distributions from a School Choice Flex Account (SCFA) or Special Education Flex Account (SEFA).

This analysis only addresses the provisions that would impact the Franchise Tax Board (FTB).

RECOMMENDATION

No position—The three-member Franchise Tax Board has not formally voted or taken a position on this bill.

SUMMARY OF AMENDMENTS

The February 27, 2025, amendments made technical changes to the bill, that do not impact the FTB.

REASON FOR THE BILL

The reason for this bill is to provide state funding for private elementary and secondary education expenses.

ANALYSIS

This bill, under the EDC and upon voter approval, would create the School Choice Flex Account Act of 2025. Under this program, funds would be disbursed to an eligible school on behalf of a student that is eligible for a SCFA or SEFA.

Under the PITL, for taxable years beginning on or after January 1, 2027, this bill would provide a gross income exclusion for distributions from a SCFA or SEFA pursuant to a participation agreement.

This bill, under the EDC, would define and provide for the following:

- Define a "School Choice Flex Account" and "Special Education Flex Account" to mean an account established under provisions added by this bill.
- Provide that "participation agreement" means the uniform contract created by the SCFA Trust Board that must be executed by the SCFA Trust Board and the parent or legal guardian of an eligible student that directs the SCFA Trust Board to disburse funds to an eligible school on behalf of the account beneficiary.

For purposes of complying with Revenue and Taxation Code (RTC) section 41, this bill would require the FTB to issue a report to the Legislature by July 1, 2027, and annually thereafter on the following:

- The number of taxpayers that received distributions from a SCFA or SEFA for this section, that would have been included in income, and
- The average dollar value of income excluded.

The RTC section 41 reporting requirements would be treated as an exception to the general prohibition against disclosure of confidential taxpayer information.

Effective/Operative Date

This bill would be effective January 1, 2027, and would only become operative if a Senate Constitutional Amendment is approved by voters at the statewide general election on November 4, 2026. If the Senate Constitutional Amendment is approved by voters, the gross income exclusion would be operative for taxable years beginning on or after January 1, 2027.

Federal/State Law

Gross Income

Existing federal and state laws provide that gross income includes all income from whatever source derived, including compensation for services, business income, gains from property, interest, dividends, rents, and royalties, unless specifically excluded.

Qualified Tuition Programs

Internal Revenue Code (IRC) section 529 (Section 529 Plan) provides tax exempt status to qualified tuition programs (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. Similar to federal law, state law provides that contributions made to a QTP are not deductible.

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% tax. Amounts in a QTP may be rolled over to another QTP for the same beneficiary or for a member of the family of that beneficiary.

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.

California generally conforms by reference to the federal rules related to state QTP rules under IRC section 529 as of the specified date of January 1, 2015, and does not conform to the federal definition for higher education expenses, which includes tuition expenses for elementary and secondary education.

Section 41

Under existing state law, legislation that would create a new tax expenditure, which includes a credit, deduction, exemption, or any other tax benefit as provided for by the state, is required to include specific goals, purposes, objectives, detailed performance indicators and data collection requirements measures to allow the Legislature to evaluate the effectiveness of the tax benefit. Legislation that would create an income exclusion, would not require detailed performance indicators and data collection requirements performance measures if the Legislature determines there is no available data to collect and report.

Implementation Considerations

The FTB has identified the following implementation considerations and is available to work with the author's office to resolve these and other considerations that may be identified.

Exclusions from gross income allow taxpayers to subtract a specified tax expenditure amount from their reported gross income for the purpose of calculating tax. The excluded income is not reported on the tax return. To capture this data, the FTB created a form (FTB Form 4197) where taxpayers may self-report items excluded from their gross income; however, this form is not required for tax filing and is not supported by all tax software companies, resulting in very little data being collected. The law (AB 3289 (Chapter 124, Statutes of 2024)), recognizes this data limitation and exempts new tax expenditures that are gross income exclusions from the Section 41 reporting requirement, if the Legislature determines there is no available data to collect and report.

This bill would require the FTB to report on the number of taxpayers that received distributions from an SCFA or SEFA account, and the average dollar value of the excluded income. The FTB's ability to meet this reporting requirement is significantly limited without a mandate to receive SCFA or SEFA distribution data from the State Controller, in addition to the gross income data limitations described above.

In addition, based on the bill language, annual deposits into SCFA and SEFA accounts will be made beginning in the 2027-28 school year (EDC 69995.02), with the Controller making at least three transfers to the Trust Fund between August 1 and June 15 of the fiscal year. The FTB is required to provide the first report by July 1, 2027, at which time there would be no funds in the accounts.

This bill uses undefined terms, "single filer" and "dual filers" within the definition of eligible student in the EDC. Income limitations are generally applied to specific filing statuses. The absence of definitions could lead to taxpayer confusion. For clarity, the author may wish to amend the bill to define these terms.

Technical Considerations

None noted.

Policy Considerations

A bill that authorizes a gross income exclusion is exempt from including information about detailed performance indicators and data collection requirements if the Legislature determines there is no available data to collect and report. This bill requires detailed performance indicators and data collection requirements. If the author determines there is no available data to collect or report, this information does not need to be included in the bill.

LEGISLATIVE HISTORY

AB 629 (Wallis, 2023/2024) would have excluded from gross income a distribution from a QTP to a Roth IRA. This bill did not pass out of the Assembly Appropriations Committee by the constitutional deadline.

SB 292 (Grove, 2023/2024) would have created a state funded trust under which parents could establish an account for their children for tuition and expenses associated with education at an eligible school as defined. Additionally, this bill would have provided a gross income exclusion for trust distributions. This bill did not pass out of the Senate Education Committee.

SB 1203 (Grove, 2023/2024) would have, similar to this bill, under the EDC and upon voter approval, created the Education Flex Account Act of 2024. Under this program, funds would be disbursed to an eligible school on behalf of a student that is eligible for an Education Flex Account or SEFA. This bill did not pass out of the Senate Education Committee.

PROGRAM BACKGROUND

None noted.

OTHER STATES' INFORMATION

None noted.

FISCAL IMPACT

The FTB's costs to implement this bill have yet to be determined. As the bill moves through the legislative process, costs will be determined.

ECONOMIC IMPACT

Revenue Estimate

This bill would result in the following revenue loss:

Estimated Revenue Impact of SB 64 as Amended on February 27, 2025
Assumed Enactment after June 30, 2026

($ in Millions)

Fiscal Year	Revenue*
2025-2026	$0
2026-2027	$0
2027-2028	-$14

*The estimated revenue loss from this proposal would increase to $25 million in fiscal year 2029-2030 when the AGI range is expanded, and to $260 million in Fiscal Year 2031-2032, when the AGI limitation is removed.

This estimate assumes that Senate Constitutional Amendment 1 (SCA 1) would be approved by voters, at the statewide general election, on November 4, 2026.

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 available data from California Department of Education and other resources, it is estimated there would be approximately 540,000 students enrolled in eligible private schools in 2027. It is estimated 17 percent, or 93,000 students, would be from parents that meet the 2027 adjusted gross income (AGI) limitation.

Of that amount, it is estimated that 4 percent, or 3,700 students, would qualify for the SEFA and each would receive a deposit of $16,000. The remaining students would qualify for School Choice Flex Accounts, and each would receive a deposit of $8,000. Based on private school data, it is expected the average qualified private school costs would equal or exceed the deposit amounts for each student and would be fully distributed each year.

This estimate assumed the distribution from the flex accounts would be the child's only source of income. After applying a $2,600 child unearned income exemption, it is estimated the amounts distributed and excluded from taxable income would be $530 million in tax year 2027. Applying the average tax rate of 1.7% for taxpayers within the qualified AGI range, would result in an estimated revenue loss of $9 million for the 2027 taxable year. It is estimated the revenue loss would increase to $26 million in taxable year 2030 when the AGI ranges are expanded and to $270 million in taxable year 2032 when AGI limitations are lifted.

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.

EQUITY IMPACT

None noted.

APPOINTMENTS

None noted.

SUPPORT/OPPOSITION

Senate Committee on Education, dated March 18, 2025.

Support

California Catholic Conference; Californians for Equal Rights Foundation; Children's Educational Opportunity Act; Fresno Christian Schools; Howard Jarvis Taxpayers; Association; Mom Army; Our Duty; Silicon Valley Association of Conservative Republicans; St. Francis Parish School; Stand Up Sacramento County; and 12 Individuals.

Opposition

California School Employees Association; California State PTA; California Tax Reform Association; California Teachers Association; CFT - A Union of Educators & Classified Professionals, AFT, AFL-CIO; SEIU California; and 1 Individual.

ARGUMENTS

Senate Committee on Education, dated March 18, 2025.

Proponents

Proponents argue that these programs empower parents by providing them with choices about where and how to educate their children, and provide students, particularly at-risk or underserved students, with better education options. They also argue that free-market competition among public and private schools improves overall school quality through competition. Interestingly, some note that arguments in favor of school vouchers shifted over the years, with less discussion about the effects of vouchers on student achievement and more discussion about both the value of choice as a right in itself and the beneficial competitive effect of voucher programs on public schools.

Opponents

Opponents argue that voucher programs divert public dollars to private schools, but without the same accountability or special education requirements as public schools. They express concerns that voucher programs divert motivated parents and students from underfunded public schools, leaving behind a larger number of disadvantaged students with fewer resources. Opponents also point out that it may be difficult for lower-income families to benefit from voucher programs, as the amount of money available through a voucher may not always cover the full costs of private school. Some raise concerns about public dollars funding religiously-affiliated private schools as a potential violation of the constitutional separation of church and state, as well as the potential for religious discrimination. Finally, some argue that these programs may

potentially benefit only a small number of children without providing the comprehensive reforms needed to strengthen the entire public education system.

LEGISLATIVE CONTACT

FTBLegislativeServices@ftb.ca.gov