Franchise Tax Board

ANALYSIS OF ORIGINAL BILL

Author:	Patterson and Vidak	Analyst:	Jessica Deitchman	Bill Number:	AB 894
Related Bills:	See Legislative History	Telephone:	845-6310	Introduced Date:	February 26,2015
		Attorney:	Bruce Langston	Sponsor	

SUBJECT:	Tuition Paid for Education & Training at Vocational Institution Credit

SUMMARY

This bill would, under the Personal Income Tax Law (PITL), allow a tax credit for a percentage of tuition costs paid to a vocational institution.

RECOMMENDATION

No position.

REASON FOR THE BILL

The reason for the bill is to encourage Californians to invest in education by providing a tax credit program that incentivizes vocational education.

EFFECTIVE/OPERATIVE DATE

As a tax levy, the bill would be effective immediately upon enactment and specifically operative on or after January 1, 2016.

FEDERAL/STATE LAW

Existing federal and state laws provide various tax credits designed to provide tax relief for taxpayers who incur certain expenses (e.g., child adoption) or to influence behavior, including business practices and decisions (e.g., research credits or economic development area hiring credits). These credits generally are designed to provide incentives for taxpayers to perform various actions or activities that they may not otherwise undertake.

Current federal law provides two types of education-related tax credits: the American Opportunity Credit and the Lifetime Learning Credit. The American Opportunity Credit allows a taxpayer, who pays the tuition, a credit of 100 percent for the first $2,000 of qualified tuition and related expenses, and a 25 percent credit for the next $2,000 of qualifying expenses, for a total tax credit of $2,500 each year per student. Up to 40 percent of the tax credit is refundable. The tax credit is phased out for a taxpayer with modified adjusted gross income between $80,000 and $90,000 for a single filer and between $160,000 and $180,000 for a joint filer. The tax credit is limited to an eligible student's first four years of postsecondary education.

Board Position:						Executive Officer	Date
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The Lifetime Learning Credit allows a taxpayer a nonrefundable credit of 20 percent of the first $10,000 of qualified tuition for a total of up to $2,000 per taxable year. The tax credit is phased out for a taxpayer with modified adjusted gross income between $53,000 and $63,000 for a single filer and between $107,000 and $127,000 for a joint filer. There is no limit to the number of taxable years that the tax credit may be claimed.

Current state law does not provide any education-related tax credits.

THIS BILL

For each taxable year beginning on or after January 1, 2016, this bill would, under the PITL, provide a tax credit equal to 15 percent of the tuition paid or incurred during the taxable year by a taxpayer for education and training obtained by the taxpayer or a dependent of the taxpayer at a vocational institution, not to exceed $2,500 per taxable year.

"Vocational Institution" would mean a private postsecondary institution that grants only certificates or associate degrees.

The credit would not be allowed to a taxpayer who deducts the tuition paid or incurred during the taxable year for education and training obtained by the taxpayer at a vocational institution as an ordinary and necessary business expense.

The credit would not be allowed to a taxpayer who pays for the tuition at a vocational institution with distributions from the taxpayer's Golden State Scholarshare College Savings Account.[1]

The credit may be carried over for up to eight years, or until exhausted.

IMPLEMENTATION CONSIDERATIONS

The department has identified the following implementation concerns. Department staff is available to work with the author's office to resolve these and other concerns that may be identified.

This bill would allow a taxpayer that pays for or incurs vocational school tuition for the "taxpayer or a dependent of the taxpayer" a credit, as specified. Because "taxpayer" can refer to one individual or in the case of a jointly field return two individuals and "dependent of the taxpayer" is an undefined phrase, it is recommended that the bill be amended to clarify the relationship between the taxpayer and the individuals that could generate a credit.

[1] The ScholarShare College Savings Plan is California's 529 college savings plan, a state-sponsored, tax-advantaged investment vehicle designed to help and encourage families to save for future qualified higher education expenses. Named for the section of the internal revenue code under which they were created, 529 plans offer valuable tax advantages. Contributions are made with money that has already been taxed. Once funds are placed in the account, investment earnings, if any, are not federally or state taxed, if withdrawn to pay for qualified higher education expenses.

It appears that the bill would allow a $2,500 credit per taxable year, but the bill's language could be interpreted to provide that the amount of tuition expenses eligible for the credit would be limited to $2,500 per taxable year. Lack of clarity can lead to disputes between taxpayers and the department. It is recommended the bill be amended to clearly express the author's intent.

The bill's prohibition on using distributions from a Golden State Scholarshare Savings Account may be overly restrictive. For example, a taxpayer that receives a specified distribution during the year that pays the vocational school tuition partially or entirely with other funds would be ineligible for the credit. Further, it is unclear how the Franchise Tax Board could verify the existence and amount of specified distributions. To avoid disputes with taxpayers and for ease of administration, it is recommended that this bill be amended.

LEGISLATIVE HISTORY

AB 2519 (Patterson, et al., 2013/2014) similar to this bill, would have created a tax credit for tuition paid to vocational institutions. AB 2519 was held in the Assembly Revenue and Taxation Committee.

AB 1441 (Beall, 2011/2012) would have created a tax credit for qualified costs at the University of California or the California State University. AB 1441 was held in the Assembly Revenue and Taxation Committee.

AB 1079 (Beall, 2011/2012) would have created a tax credit for qualified costs at the University of California or the California State University. AB 1079 was held in the Assembly Revenue and Taxation Committee.

OTHER STATES' INFORMATION

The states surveyed include *Florida, Illinois, Massachusetts, Michigan, Minnesota,* and *New York.* These states were selected due to their similarities to California's economy, business entity types, and tax laws.

New York provides a college tuition expenses tax credit of up to $400 per student, per year; however, none of these states provide a tax credit comparable to the one discussed in this bill.

FISCAL IMPACT

The costs to administer this bill have yet to be determined. As the bill continues to move through the legislative process, costs will be identified and an appropriation will be requested, if necessary.

ECONOMIC IMPACT

Revenue Estimate

This bill would result in the following revenue losses:

Estimated Revenue Impact of AB 894 As Introduced February 26, 2015 Assumed Enactment After June 30, 2015 ($ in Millions)		
2015-16	2016-17	2017-18
- $30	- $75	- $110

This analysis does not account for changes in employment, personal income, or gross state product that could result from this bill.

Revenue Discussion

Based on data from the Department of Finance and vocational schools, the number of graduates attending vocational school and paying their own tuition is projected to be 90,000 in 2016. Based on the same data, the average annual cost of attending a private vocational school is $14,000 resulting in estimated vocational school tuition expense of $1.2 billion.

A credit of 15 percent of qualified tuition expenses would result in a credit generated of $190 million in 2016. The credit generated is reduced by 10 percent to account for taxpayers who are eligible for the credit, but would have no tax liability and are unable to use the credit, and by another 8 percent to account for taxpayers who are ineligible for the credit either because they deducted the tuition as a regular business expense, or the tuition payment was made with Scholarshare distributions. This estimate assumes the full impact of this bill would be phased in over four years with 70 percent of eligible taxpayers taking the credit in the first year, 80 percent in the second year, 90 percent in the third year and 100 percent in subsequent years. It is assumed that eligible taxpayers would use 50 percent of the credit in year one, 25 percent in year two, 15 percent in year three, and 5 percent in year four, resulting in credits used of $55 million in 2016, $90 million in 2017 and $120 million in 2018. The tax year estimates are converted to fiscal year estimates and then rounded to arrive at the estimates shown in the table above.

SUPPORT/OPPOSITION

Support: None provided.

Opposition: None provided.

ARGUMENTS

Proponents: Some could argue that this bill would improve access to vocational based post-high school training and provide more highly skilled candidates to the state's employers.

Opponents: Some could argue that limiting a tax credit to tuition for vocational education could be overly narrow especially in light of the recent increases in tuition for the state's college and university systems.

POLICY CONCERNS

This bill lacks a sunset date. Sunset dates generally are provided to allow periodic review of a credit's effectiveness by the Legislature.

This credit would be available to resident and nonresident taxpayers that pay tuition to a vocational institution regardless of the location of the vocational school.

This bill could inadvertently encourage individuals to avoid opening Golden State Scholarshare College Savings Accounts in favor or other 529[2] plans because the credit would be unavailable to a taxpayer that paid for vocational institution tuition from distributions received from a Golden State Scholarshare College Savings Accounts.

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[2] A 529 plan is a tax-advantaged investment vehicle designed to encourage saving for future higher education expenses of a designated beneficiary.