DEPARTMENT OF FINANCE BILL ANALYSIS

AMENDMENT DATE: 06/21/2012
POSITION: Oppose

BILL NUMBER: SB 1356
AUTHOR: De Leon, Kevin
RELATED BILLS: SB 1466

BILL SUMMARY: Income Taxes: Higher Education Investment Tax Credit

This bill would, for taxable years 2013, 2014, and 2015, allow a credit ranging from 50 to 60 percent of a contribution to the Higher Education Investment Tax Credit Program, established by this bill, for purposes of providing Cal Grants to students. Credits granted shall not exceed $100 million in any single calendar year. This bill would only become operative if SB 1466 of the 2011-12 Regular Session is enacted and takes effect on or before January 1, 2013.

FISCAL SUMMARY

The Franchise Tax Board (FTB) estimates that this bill would result in a loss of General Fund revenues of $45 million in 2012-13, $90 million in 2013-14, and $95 million in 2014-15.

The FTB estimates one-time costs of approximately $67,000 in 2012-13 to implement the credit and $3,000 in 2013-14 to develop and implement the process for receving and transcribing the information provided by the California Educational Facilities Authority (CEFA) to the department. FTB estimates ongoing costs of $50,000 to maintain and monitor the reported information for the remaining life of the credit.

SUMMARY OF CHANGES

Amendments to this bill since our analysis of the May 1, 2012 version include the following amendments which did not change our position:

- The maximum annual aggregate credit cap was reduced from $500 million to $100 million.
- The administering agency was changed to the CEFA from the Treasurer.

COMMENTS

The Department of Finance is opposed to this bill for the following reasons:

- This bill could, if the tax credit is fully subscribed, cost the General Fund up to $100 million per year at a time when the state is in a fiscal crisis and continues to face significant budget deficits.
- Given that this tax credit is new and untested, it is unclear if it would actually result in new donations that were not previously planned, or if it would simply redirect planned contributions from elsewhere.
- The Department of Finance is opposed to new policies that would expand the General Fund obligation for state-funded financial aid.

This bill is contingent upon the enactment of SB 1466, which would increase eligibility for potential Cal-Grant recipients. SB 1466 must be enacted on or before January 1, 2013.

Analyst	Date	Program Budget Manager	Date
C. White		Kristin Shelton	

Department Deputy Director | Date

Governor's Office: By: Date: Position Approved_______
Position Disapproved_______

ANALYSIS

1. Programmatic Analysis

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

Existing federal and state laws allow individuals to take a fixed standard deduction, indexed for inflation, or the amount of a taxpayer's itemized deductions, whichever is greater. Certain expenses, such as medical expenses incurred by the taxpayers, charitable contributions, interest, and taxes, are deductible as itemized deductions.

Under current federal law, any contribution to a state agency is deductible for federal purposes on federal tax returns.

This bill would, for both the Personal Income Tax Law and the Corporation Tax Law, for taxable years beginning on or after January 1, 2013, and before January 1, 2016, allow a tax credit equal to 60 percent in 2013, 55 percent in 2014, and 50 percent in 2014 of the contribution to the newly created Higher Education Investment Tax Credit Program Special Fund.

This bill would specify that the aggregate amount of the credit that may be allocated and certified shall not exceed $100 million in any calendar year. Credits not used in the first year earned can be carried forward to the subsequent six years.

This bill would disallow a state deduction for any amount used to calculate the tax credit.

This bill would create the Higher Education Investment Tax Credit Program Special Fund and specifies that all revenue in this fund, upon appropriation by the Legislature, shall be allocated to the Student Aid Commission for purposes of awarding Cal Grants to students pursuant to Section 69432.75 of the Education Code.

Discussion

According to the author's office, the purpose of this bill is to expand Cal Grants to middle class Californians through an annual $500 million [subsequent amendment changed cap to $100 million] Higher Education Investment Tax Credit Fund and leveraging of federal funding. A background sheet provided by the author's office states the following: "During tough times like these we need novel approaches to steer the state back on track. The Franchise Tax Board (FTB) predicts that the Higher Education Investment Tax Credit Fund program would be fully subscribed due to the high incentive to taxpayers. For every dollar donated to the Fund, the individual taxpayer or the corporate donor would receive 65 cents back from the state and 33 cents back from the federal government. In the end, the taxpayer is only out of pocket [2 cents] and California earns interest on the consumer's 35-cent expenditure. California only gets 78 cents back for every dollar state taxpayers send to Washington. It's time to leverage federal dollars to help offset skyrocketing college tuition."

Since the author's comments above, the bill was amended to reduce the the tax credit from 65 percent of the contribution for five years to 60, 55, and 50 percent of the contribution amount in the 2013, 2014, and 2015 tax years, respectively. Despite the reduction, there would still be a strong incentive for taxpayers to donate. For example, even at the lowest 50 percent rate in tax year 2015, a taxpayer

ANALYSIS (continued)

with a 30 percent federal tax rate and subject to the federal Alternative Minimum Tax (AMT) could receive around 80 cents back on every dollar donated through the state tax credit and a federal deduction. The leveraging of federal dollars is achieved since a contribution to a state agency can be deductible for federal purposes on a federal tax return. Finance notes that taxpayers not subject to the federal AMT could receive a substantially lower federal benefit as it could reduce the amount of state and local taxes that they can deduct on their federal return.

Taxpayer behavior and credit usage is very hard to predict, but if this tax credit was fully subscribed, it would cost the General Fund up to $100 million per year for the additional credit usage. In return for that $100 million, the Higher Education Investment Tax Credit Fund would receive around $167 to $200 million in contributions, depending if the tax credit percentage was 60, 55, or 50 percent. Although this leveraging of federal dollars and the receipt of $1.67 to $2 for every dollar spent appears favorable, it is unknown how much of the donations would be a redirection of existing planned charitable giving to simply take advantage of a tax credit that is more generous than typical deductions for charitable giving.

Finance notes that to the extent this bill reduces the amount of General Fund proceeds of taxes through the tax credit, the Proposition 98 guarantee would decrease, which could affect funding for K-12 education.

In recent years, the Administration has sought to reduce the size of the Cal Grant program, which is contrary to this bill's objective to significantly expand the program. The Budget Act of 2012 includes $77.6 million of General Fund reductions by restricting Cal Grant participation and award amounts. The 2012-13 May Revision proposed much larger reductions to the Cal Grant program. Prior to 2001, the Cal Grant program offered a capped number of awards to students and award amounts were specified in the Budget. Under that construct, the program supported 130,000 students at a cost of $462 million in 2000-01. The program is now an entitlement and has been one of the fastest growing programs in the state. Costs have increased due to an increased number of students participating in the program and University of California and California State University tuition increases. The number of students in the program have increased to an estimated 259,000 and costs have increased to $1.6 billion in 2012-13.

This bill would not become effective unless SB 1466 of the 2011-12 Regular Session becomes effective on or before January 1, 2013. SB 1466 would expand Cal Grant award eligibility for students whose annual household income does not exceed $100,000 and who otherwise meet Cal Grant eligibility requirements as they existed in 2011-12. The provisions of SB 1466 would remain in effect until December 1, 2018, or until all funds are expended, whichever date comes last.

2. Fiscal Analysis

The Franchise Tax Board (FTB) estimates that this bill would result in a loss of General Fund revenues of $45 million in 2012-13, $90 million in 2013-14, and $95 million in 2014-15. There would be further losses in 2015-16 related to the generation of credits.

Although up to $100 million in credits may be granted in a tax year, all the credits would not be used in the same year awarded and will thus be carried forward in to subsequent tax years. Credits that are applied will affect estimated payments and final return payments in any given fiscal year.

AUTHOR	AMENDMENT DATE	BILL NUMBER
De Leon, Kevin	06/21/2012	SB 1356

ANALYSIS (continued)

As with any new tax credit, there is considerable uncertainty as to the extent it will actually be used by taxpayers and corporate donors. FTB assumes that the credit will be nearly fully subscribed and that the revenue impact will affect 2012-13 because donations for tax year 2013 will affect estimated payments in the 2012-13 fiscal year.

The FTB estimates one-time costs of approximately $67,000 in 2012-13 to implement the credit and $3,000 in 2013-14 to develop and implement the process for receving and transcribing the information provided by CEFA to the department. FTB estimates ongoing costs of $50,000 to maintain and monitor the reported information for the remaining life of the credit.

Code/Department Agency or Revenue Type	SO LA CO RV	(Fiscal Impact by Fiscal Year) (Dollars in Thousands) PROP 98	FC	2012-2013	FC	2013-2014	FC	2014-2015	Fund Code
1147/Pers Inc Tax	RV	Yes	U	-45,000	U	-90,000	U	-95,000	0001
1730/FTB	SO	No	U	-67	U	-53	U	-50	0001