Date of Hearing: April 25, 2017

ASSEMBLY COMMITTEE ON HIGHER EDUCATION
Jose Medina, Chair
AB 1356 (Eggman) – As Amended April 6, 2017

SUBJECT: Higher Education Assistance Fund: personal income taxes: additional tax

SUMMARY: Imposes an additional 1% tax on taxable personal income exceeding $1 million and earmarks the resulting revenue for student tuition and fees at the University of California (UC), the California State University (CSU), and the California Community Colleges (CCC), all contingent on a Constitutional Amendment (ACA 13) being approved by the voters in 2018. Specifically, **this bill**:

1) Enacts, effective January 1, 2019, an additional 1% tax on taxable personal income exceeding $1 million, bringing the total marginal tax rate for this income bracket generally to 14.3%.

2) Specifies that the tax cannot be reduced by the application of tax credits and that the tax applies equally to taxpayers regardless of filing status. In addition, the $1 million tax bracket will not be subject to indexing for inflation.

3) Establishes the Higher Education Assistance Fund to receive the revenues resulting from (1), and continuously appropriates moneys in the fund to provide student financial assistance toward the costs of tuition and fees for in-state, undergraduate students enrolled at UC, CSU, and the CCC.

4) States that the additional funding provided by this bill shall be to expand student financial assistance, and that the funds shall not be used to supplant existing state or federal financial aid funding.

5) States that the provisions of this bill will become operative only if ACA 13 of the 2017-18 legislative session is approved by the voters.

EXISTING LAW:

Federal Law:

Under the Pell Grant program, established as part of the Higher Education Act of 1965 and subsequent amendments, provides grants generally to undergraduate students based on financial need. The maximum grant amount, which is indexed to inflation, is $5,815 for 2016-17. (USC, Title 20, Section 1070a.)

State Law:

1) Authorizes the UC Regents and the CSU Trustees to charge various fees and prohibits certain fees from applying to specified categories of students.

2) Provides that statutes related to UC (and most other aspects of the governance and operation of UC) are applicable only to the extent that the UC Regents make such provisions applicable. (Education Code (EC) Section 67400.)

3) Confers upon the CSU Trustees the powers, duties, and functions with respect to the management, administration, and control of the CSU system. (EC Sect. 66606.)

4) Requires CSU, and requests UC, to annually report to the Legislature on their respective institutional financial aid programs, including the total amount expended for institutional aid and the financial need of undergraduate need-based aid recipients. (EC Sect. 66021.1.)

5) Establishes a $46 per semester unit fee at the California Community Colleges, and provides fee waivers for specified types of students. (EC Sect. 76300.)

6) Establishes the Cal Grant program to provide tuition and other assistance to eligible students attending qualified institutions:

   a) Cal Grant A Entitlement Awards. Students that meet income, asset and other eligibility requirements, have at least a 3.0 grade point average, and apply either the year they graduate from high school or the following year are entitled to an award that provides coverage for tuition and fees at UC and CSU. (EC Section 69434.)

   b) Cal Grant B Entitlement Awards. Students that meet income and asset thresholds (lower than Cal Grant A) and other eligibility requirements, have at least a 2.0 GPA and apply either the year they graduate from high school or the following year are entitled to a living allowance, in addition to covering tuition and fees at UC and CSU. Awards for first-year students are limited to an allowance for books and living expenses ($1,678). In the second and subsequent years, the award also provides tuition and fee support. (EC Sect. 69435.)

   c) CCC Transfer Entitlement Awards. Cal Grant A and B awards are guaranteed to every student who graduated from a California high school after June 30, 2000, was a California resident at the time of high school graduation, transferred to a qualifying baccalaureate-degree granting institution from a CCC during the award year, was under the age of 28 at the time of the transfer, and had a minimum CCC GPA of 2.4. (EC Sect. 69436.)

   d) Competitive Cal Grant A and B Awards. Students who are not eligible for entitlement awards may compete for a Cal Grant A or B Competitive award. The award benefits and eligibility requirements are the same as the entitlement program, but awards are not guaranteed. Annually, 25,750 Cal Grant Competitive awards are available. Of these, 12,875 (one-half) are for students who do not qualify for a Cal Grant Entitlement award, but who otherwise meet the Cal Grant requirements. The remaining awards are set aside for eligible CCC students. (EC Sect. 69437.)

7) Establishes personal income tax rates that increase within specified increments of increasing income. Rates for 2016 range from 1% for the first $16,000 of taxable income (joint filers) to 9.3% for joint filer taxable income between $103,000 and $526,000. (Revenue and Taxation (R&T) Sect. 17041.)

8) Establishes the following additional income tax rates for joint filer taxable income exceeding $526,000: 10.3% for between $526,000 and $632,000; 11.3% for between $632,000 and

$1,053,000; 12.3% for income above $1,053,000. (California Constitution, Article XIII, Section 36, as added by Proposition 30 of 2012, for taxable years 2012 through 2018, and extended by Proposition 55 of 2016, for taxable years through 2030.)

9) Establishes an additional 1% tax on taxable personal income exceeding $1 million, specifies that the tax cannot be reduced by the application of tax credits, that the tax applies equally to taxpayers regardless of filing status, will not be subject to indexing for inflation, and earmarks the revenues from this tax to fund mental health services. (R&T Sect. 17043, as added by Proposition 63 in 2004).

FISCAL EFFECT: A preliminary estimate by the Franchise Tax Board (FTB) estimates revenues of $1.1 billion in 2019-20 and $2.1 billion in 2020-21, assuming ACA 13 is approved by the voters. The FTB notes that, because the income reported by high-income taxpayers is volatile, the revenue impact of taxes imposed on these taxpayers can vary considerably from year to year.

COMMENTS:

Purpose. Information from the author's office cites the large increases in tuition, noting that between 1969 and 2015, tuition increase by 530% at UC and 685% at CSU. Over this same time period median household income increased only 10% and the median price of a home in California increased by 290%. The author notes that the state's financial aid programs have gaps that make even some low-income students ineligible for state aid, and that many middle income students only have a portion of their tuition costs covered by aid programs. AB 1356 proposes a new 1% tax on incomes exceeding $1 million to cover the gap between current financial aid programs and in-state tuition paid by in-state undergraduate students at UC, CSU, and the CCC.

Sources and Uses of Revenue. Based on the most recent data available from the FTB (for 2014), the tax proposed in this bill would be paid by around 66,000 households in California and generate around $2.1 billion over the first full fiscal year (which coincides with an academic year).

Based on an estimate by the Legislative Analyst's Office of the portions of total tuition and mandatory systemwide fees paid by state aid programs and by students, respectively, it appears that these tax revenues would roughly cover what would be the students' share of tuition and fee costs in 2017-18—about $900 million at UC, $750 million at CSU, and $450 million at the CCC.

Who Benefits from This Bill?

UC Students. When the UC Regents acted in January to adopt a tuition increase for 2017-18, the university estimated that increases in financial aid—through the state's Cal Grant program and the Middle Class Scholarship (MCS) program and UC's institutional aid program—will cover these increased costs for about two-thirds of UC undergraduates. In general, it can be assumed that most of these UC students also have their existing base tuition and fees covered by financial aid programs. Therefore about 55,000 UC students would have their tuition and fees covered under this bill. For about one-half of these students, UC does not know their family income because they did not file a Free Application for Federal Student Aid (FAFSA) or a Dream Act application. Most of these students are likely from families with sufficient income such that the student would not qualify for any financial aid. Another 18,600 of these UC students are from families with annual income exceeding

$138,000. About 8,000 UC students who receive an MCS—which covers a portion of tuition costs not covered by other financial aid programs, and averages about $2,400 per recipient in 2017-18—would have the balance of their tuition cost covered by this bill.

CSU Students. When the CSU Trustees acted in March to adopt a tuition increase for 2017-18, the university estimated that state and university financial aid programs will fully cover the 2017-18 fee increase for more than 60% of the system's undergraduates, or about 255,000 students. Again, assuming base tuition is already covered for these students, the remaining 130,000 undergraduates would have all or a portion of the tuition and fees covered by this bill. As with UC, many of these students are likely from affluent families whose income exceeds the maximum allowable for eligibility under state and federal financial aid programs. Unlike UC, however, there is probably a considerable share of these students who, while middle- or even low-income, are not eligible for financial aid and would most benefit from this bill.

CCC Students. Over the 2015-16 academic year, the CCC served about 2.3 million students, with about 1.6 million students enrolling in each of the fall 2015 and spring 2016 semesters. For that same year, about one million students, or 43% of all students, received a CCC Board of Governors (BOG) fee waiver—an equivalent of $800 million in waived fees. (The vast majority of students receiving a BOG waiver do so because of limited family income or demonstrated financial need.) This bill would therefore assist those part-time and full-time CCC students not eligible for a BOG waiver by covering their $46/unit costs.

Who Pays for This Bill? As mentioned earlier, in 2014 about 66,000 tax filers in California (0.4% of all filers) had taxable income exceeding $1 million, and thus would be subject to the additional tax imposed by AB 1356. This bill would bring the top marginal tax rate for these households to 14.3%. This cohort of taxpayers already pays a disproportionate share of state income taxes. While their aggregate income was about 20% of the total state personal income in 2014, they paid almost 40% of the state's personal income tax. To put this another way, these 66,000 tax filers paid as much of the personal income tax as the 15.4 million tax filers in the state with incomes below $300,000, and whose aggregate personal income is about two-thirds of all state personal income.

Impact to the Postsecondary Institutions? In reducing part of the cost of college attendance, by covering tuition costs not currently covered by state and federal aid programs, this bill could increase enrollment demand at the public postsecondary institutions. The amount and distribution of this new demand is unknown, but could be significant and would increase funding pressures on the segments. This bill provides no funding to the segments; only to students. While increasing demand at the public institutions, the bill might reduce enrollment demand at some private postsecondary institutions, both nonprofit and for-profit. Students attending these institutions would see no additional financial aid, and in fact, the maximum Cal Grant award at nonprofit schools is scheduled to decrease in 2017-18, absent legislative action.

Issues for Committee Consideration. This bill raises some fundamental issues for the committee, both with regard to its revenues and its proposed expenditures.

Is This the Appropriate Revenue Source? As illustrated above, California's income tax structure is already highly progressive. Should relatively few taxpayers, who already shoulder a significant share of the state tax burden, be asked to pay more for a new, broad-based benefit? Moreover, since the income of these filers is highly volatile, does this bill provide a sufficiently-reliable source of revenue for what would be an ongoing commitment. For example, between tax year 2007 and 2009, when the Great Recession hit, the aggregate income of filers with taxable income exceeding $1 million fell by 50%, and their total tax liability declined from $19 billion to $9.4 billion.

Is This the Best Use of the Funds? As described earlier, this bill would cover tuition and fee costs—currently not covered by financial aid—for well over one million students attending one of the state's three systems of public postsecondary education. (While the vast majority of these beneficiaries attend the community colleges, most of the benefit would go to cover the much higher fee levels at UC or CSU.) Tuition is but one element in the cost of attending college, however, the others being books and supplies, food, housing, transportation, and personal/miscellaneous. Notwithstanding that California maintains a generous portfolio of financial aid programs to offset tuition costs for a majority of its UC and CSU students and a large share of CCC students, the college affordability challenge for many students concerns these non-tuition costs.

The state's longstanding policy has been to increase Cal Grant amounts to cover tuition increases at the public segments, but state support to cover non-tuition costs have seen little increase. The Cal Grant B access award, which helps recipients with non-tuition costs, was $900 in 1969-70. Had this award been continuously-adjusted for inflation, it would be around $6,300, but instead is only $1,670. At the same time, the cost of housing has become a greater challenge for many Californians, and particularly for renters, which of course includes a large proportion of college students. According to Zillow, median apartment rents in Los Angeles County have risen 23% in just the last three years, to $2,400, and the statewide median is up 26% over this time. As expected, these burdens generally fall the hardest on the poorest students, who are more likely to have to take out loans and graduate with debt.

Given the above, is allocating an additional $2 billion in new revenue to generally less needy students preferable to directing at least some portion of those funds to assist more needy students with their non-tuition costs?

Arguments in Support. The Faculty Association of the California Community Colleges argues that high-income earners have reaped great benefits from the reduction in the top federal marginal tax rates since the 1980s , including reductions in capital gains taxes, and that the benefits of this bill are worth the additional contribution being asked of these taxpayers.

Arguments in Opposition. Opponents generally cite the already high marginal tax rate on high-income earners, the volatility of their income, and the inappropriateness of burdening such a small segment of the population for a higher education-related program that has broad personal and societal benefit. Opponents are also concerned about the potential impact on small businesses who file under the Personal Income Tax Law.

Related Legislation.

1) ACA 13 (Eggman), pending referral, would amend the State Constitution to provide that the revenues derived from the income tax increase in this bill would not be included either in the calculations of the minimum Proposition 98 guarantee or the state appropriations (Gann) limit.

2) SB 236 (Nguyen), which in part freezes tuition and mandatory systemwide fees at UC and CSU for 2018-19 through 2022-23, failed passage in Senate Education.

Budget Subcommittee Action. On March 14, the Assembly Budget Subcommittee #2 approved a "Degrees Not Debt" scholarship proposal, which would provide a grant to qualifying UC and CSU students to their college costs not currently covered by the sum of other aid, a student contribution and an expected family contribution. The program would begin in 2018-19 and would be phased in over five years, when the estimated annual cost would be $1.2 to $1.6 billion.

REGISTERED SUPPORT / OPPOSITION:

Support

California Federation of Teachers
Faculty Association of California Community Colleges

Opposition

California Chamber of Commerce
California Taxpayers Association
Howard Jarvis Taxpayers Association
National Federation of Independent Businesses

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