

chair **Betty T. Yee**
member **George Runner**
member **Michael Cohen**



STATE OF CALIFORNIA
Franchise Tax Board

Summary of Federal Income Tax Changes
2017

Laws Affected

Personal Income Tax Law

Corporation Tax Law

Administration of Franchise and Income Tax Laws

Summary of Federal Income Tax Changes
2017

Prepared by the Staff of the
Franchise Tax Board
STATE OF CALIFORNIA

Members of the Board:
Betty T. Yee, Chair
George Runner, Member
Michael Cohen, Member

Executive Officer: Selvi Stanislaus

This report is submitted in fulfillment of the requirement in Revenue and Taxation Code section 19522.

An Act to Provide for Reconciliation Pursuant to Titles II and V of the
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 Public Law 115-97, December 22, 2017

operating or capital loss carrybacks, and any excess may be carried forward for up to five years.¹⁵⁹ As a result, California does not conform to the increased limitation for certain charitable contributions for corporations.

Impact on California Revenue

Estimated Conformity Revenue Impact of Increased Limitation for Certain Charitable Contributions For Taxable Years Beginning On or After January 1, 2018 Enactment Assumed After June 30, 2018			
2017-18	2018-19	2019-20	2020-21
N/A	- \$22,000,000	- \$15,000,000	- \$15,000,000

<u>Section</u>	<u>Section Title</u>
11024	Increased Contributions to ABLE Accounts

Background

Qualified ABLE Programs

The IRC provides for a tax-favored savings program intended to benefit disabled individuals, known as qualified ABLE programs.¹⁶⁰ A qualified ABLE program is a program established and maintained by a State or agency or instrumentality thereof. A qualified ABLE program must meet the following conditions: (1) under the provisions of the program, contributions may be made to an account (an “ABLE account”), established for the purpose of meeting the qualified disability expenses of the designated beneficiary of the account; (2) the program must limit a designated beneficiary to one ABLE account; and (3) the program must meet certain other requirements discussed below. A qualified ABLE program is generally exempt from income tax, but is otherwise subject to the taxes imposed on the unrelated business income of tax-exempt organizations.

A designated beneficiary of an ABLE account is the owner of the ABLE account. A designated beneficiary must be an eligible individual (defined below) who established the ABLE account and who is designated at the commencement of participation in the qualified ABLE program as the beneficiary of amounts paid (or to be paid) into and from the program.

Contributions to an ABLE account must be made in cash and are not deductible for Federal income tax purposes. Except in the case of a rollover contribution from another ABLE account, an ABLE account must provide that it may not receive aggregate contributions during a taxable year in excess of the amount under section 2503(b) of the IRC (the annual gift tax exemption). For

¹⁵⁹ R&TC section 24357.

¹⁶⁰ IRC section 529A.

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2017, this is \$14,000.¹⁶¹ Additionally, a qualified ABLE program must provide adequate safeguards to ensure that ABLE account contributions do not exceed the limit imposed on accounts under the qualified tuition program of the State maintaining the qualified ABLE program. Amounts in the account accumulate on a tax-deferred basis (i.e., income on accounts under the program is not subject to current income tax).

A qualified ABLE program may permit a designated beneficiary to direct (directly or indirectly) the investment of any contributions (or earnings thereon) no more than two times in any calendar year and must provide separate accounting for each designated beneficiary. A qualified ABLE program may not allow any interest in the program (or any portion thereof) to be used as security for a loan. Distributions from an ABLE account are generally includible in the distributee's income to the extent consisting of earnings on the account.¹⁶² Distributions from an ABLE account are excludable from income to the extent that the total distribution does not exceed the qualified disability expenses of the designated beneficiary during the taxable year. If a distribution from an ABLE account exceeds the qualified disability expenses of the designated beneficiary, a pro rata portion of the distribution is excludable from income. The portion of any distribution that is includible in income is subject to an additional 10-percent tax unless the distribution is made after the death of the beneficiary. Amounts in an ABLE account may be rolled over without income tax liability to another ABLE account for the same beneficiary¹⁶³ or another ABLE account for the designated beneficiary's brother, sister, stepbrother or stepsister who is also an eligible individual.

Except in the case of an ABLE account established in a different ABLE program for purposes of transferring ABLE accounts,¹⁶⁴ no more than one ABLE account may be established by a designated beneficiary. Thus, once an ABLE account has been established by a designated beneficiary, no account subsequently established by such beneficiary shall be treated as an ABLE account.

A contribution to an ABLE account is treated as a completed gift of a present interest to the designated beneficiary of the account. Such contributions qualify for the per-donee annual gift tax exclusion (\$14,000 for 2017) and, to the extent of such exclusion, are exempt from the generation skipping transfer (GST) tax. A distribution from an ABLE account generally is not subject to gift tax or GST tax.

¹⁶¹ This amount is indexed for inflation. In the case that contributions to an ABLE account exceed the annual limit, an excise tax in the amount of six percent of the excess contribution to such account is imposed on the designated beneficiary. Such tax does not apply in the event that the trustee of such account makes a corrective distribution of such excess amounts by the due date (including extensions) of the individual's tax return for the year within the taxable year.

¹⁶² The rules of IRC section 72 apply in determining the portion of a distribution that consists of earnings.

¹⁶³ For instance, if a designated beneficiary were to relocate to a different State.

¹⁶⁴ In which case the contributor ABLE account must be closed 60 days after the transfer to the new ABLE account is made.

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Eligible Individuals

As described above, a qualified ABLE program may provide for the establishment of ABLE accounts only if those accounts are established and owned by an eligible individual, such owner referred to as a designated beneficiary. For these purposes, an eligible individual is an individual either (1) for whom a disability certification has been filed with the Secretary for the taxable year, or (2) who is entitled to Social Security Disability Insurance benefits or SSI benefits¹⁶⁵ based on blindness or disability, and such blindness or disability occurred before the individual attained age 26.

A disability certification means a certification to the satisfaction of the Secretary, made by the eligible individual or the parent or guardian of the eligible individual, that the individual has a medically determinable physical or mental impairment, which results in marked and severe functional limitations, and which can be expected to result in death or which has lasted or can be expected to last for a continuous period of not less than 12 months, or is blind (within the meaning of section 1614(a)(2) of the Social Security Act). Such blindness or disability must have occurred before the date the individual attained age 26. Such certification must include a copy of the diagnosis of the individual's impairment and be signed by a licensed physician.¹⁶⁶

Qualified Disability Expenses

As described above, the earnings on distributions from an ABLE account are excluded from income only to the extent total distributions do not exceed the qualified disability expenses of the designated beneficiary. For this purpose, qualified disability expenses are any expenses related to the eligible individual's blindness or disability which are made for the benefit of the designated beneficiary. Such expenses include the following expenses: education, housing, transportation, employment training and support, assistive technology and personal support services, health, prevention and wellness, financial management and administrative services, legal fees, expenses for oversight and monitoring, funeral and burial expenses, and other expenses, which are approved by the Secretary under regulations and consistent with the purposes of section 529A.

Transfer to State

In the event that the designated beneficiary dies, subject to any outstanding payments due for qualified disability expenses incurred by the designated beneficiary, all amounts remaining in the deceased designated beneficiary's ABLE account not in excess of the amount equal to the total medical assistance paid such individual under any State Medicaid plan established under title XIX of the Social Security Act shall be distributed to such State upon filing of a claim for payment by such State. Such repaid amounts shall be net of any premiums paid from the account or by or on behalf of the beneficiary to the State's Medicaid Buy-In program.

¹⁶⁵ These are benefits, respectively, under Title II or Title XVI of the Social Security Act.

¹⁶⁶ No inference may be drawn from a disability certification for purposes of eligibility for Social Security, SSI or Medicaid benefits.

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Treatment of ABLE Accounts under Federal Programs

Any amounts in an ABLE account, and any distribution for qualified disability expenses, shall be disregarded for purposes of determining eligibility to receive, or the amount of, any assistance or benefit authorized by any Federal means-tested program. However, in the case of the SSI program, a distribution for housing expenses is not disregarded, nor are amounts in an ABLE account in excess of \$100,000. In the case that an individual’s ABLE account balance exceeds \$100,000, such individual’s SSI benefits shall not be terminated, but instead shall be suspended until such time as the individual’s resources fall below \$100,000. However, such suspension shall not apply for purposes of Medicaid eligibility.

Saver’s Credit

Present law provides a nonrefundable tax credit for eligible taxpayers for qualified retirement savings contributions.¹⁶⁷ The maximum annual contribution eligible for the credit is \$2,000 per individual. The credit rate depends on the AGI of the taxpayer. For this purpose, AGI is determined without regard to certain excludable foreign-source earned income and certain U.S. possession income.

For taxable years beginning in 2017, married taxpayers filing joint returns with AGI of \$61,500 or less, taxpayers filing head of household returns with AGI of \$46,125 or less, and all other taxpayers filing returns with AGI of \$30,750 or less are eligible for the credit. As the taxpayer’s AGI increases, the credit rate available to the taxpayer is reduced, until, at certain AGI levels, the credit is unavailable. The credit rates based on AGI for taxable years beginning in 2016 are provided in the table below. The AGI levels used for the determination of the available credit rate are indexed for inflation.

Credit Rates for Saver’s Credit

Joint Filers	Heads of Households	All Other Filers	Credit Rate
\$0 – \$37,000	\$0 – \$27,750	\$0 – \$18,500	50 percent
\$37,001 – \$40,000	\$27,751 – \$30,000	\$18,501 – \$20,000	20 percent
\$40,001 – \$62,000	\$30,001 – \$46,500	\$20,001 – \$31,000	10 percent
Over \$62,000	Over \$46,500	Over \$31,000	0 percent

The saver’s credit is in addition to any deduction or exclusion that would otherwise apply with respect to the contribution. The credit offsets alternative minimum tax liability as well as regular tax liability. The credit is available to individuals who are 18 years old or older, other than individuals who are full-time students or claimed as a dependent on another taxpayer’s return.

Qualified retirement savings contributions consist of (1) elective deferrals to an IRC section 401(k) plan, an IRC section 403(b) plan, a governmental IRC section 457 plan, a SIMPLE plan, or a SARSEP; (2) contributions to a traditional or Roth IRA; and (3) voluntary after-tax employee

¹⁶⁷ IRC section 25B.

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contributions to a qualified retirement plan or IRC section 403(b) plan. Under the rules governing these arrangements, an individual's contribution to the arrangement generally cannot exceed the lesser of an annual dollar amount (for example, in 2017, \$5,500 in the case of an IRA of an individual under age 50) or the individual's compensation that is includible in income. In the case of IRA contributions of a married couple, the combined includible compensation of both spouses may be taken into account.

The amount of any contribution eligible for the credit is reduced by distributions received by the taxpayer (or by the taxpayer's spouse if the taxpayer files a joint return with the spouse) from any retirement plan to which eligible contributions can be made during the taxable year for which the credit is claimed, during the two taxable years prior to the year for which the credit is claimed, and during the period after the end of the taxable year for which the credit is claimed and prior to the due date (including extensions) for filing the taxpayer's return for the year. Distributions that are rolled over to another retirement plan do not affect the credit.

New Federal Law (IRC section 25B and 529A)

The provision increases the contribution limitation to ABLE accounts under certain circumstances. While the general overall limitation on contributions (the per-donee annual gift tax exclusion (\$14,000 for 2017)) remains the same, the limitation is increased with respect to contributions made by the designated beneficiary of the ABLE account. Under the provision, after the overall limitation on contributions is reached, an ABLE account's designated beneficiary may contribute an additional amount, up to the lesser of (a) the Federal poverty line for a one-person household; or (b) the individual's compensation for the taxable year.

Additionally, the provision allows a designated beneficiary of an ABLE account to claim the saver's credit for contributions made to his or her ABLE account.

Effective Dates

For contribution increases related to beneficiary compensation, the provision applies to taxable years beginning after December 22, 2017, and ends for contribution increases made before January 1, 2026.

For the provision allowing the saver's credit for ABLE contributions, the provision applies to taxable years beginning after December 22, 2017, and ends for contributions made before January 1, 2026.

California Law (R&TC section 17140.4)

California conforms, under the PITL, relating to qualified ABLE programs and accounts under IRC section 529A, as of the "specified date" of January 1, 2015,¹⁶⁸ with modifications, but does not conform to the increased contribution limitation to ABLE accounts under certain circumstances.

¹⁶⁸ R&TC section 17024.5.

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California does not conform to the saver’s credit under IRC section 25B, and has no comparable credit.

Impact on California Revenue

Estimated Conformity Revenue Impact of Increased Contributions to ABLE Accounts For Taxable Years Beginning On or After January 1, 2018 Enactment Assumed After June 30, 2018			
2017-18	2018-19	2019-20	2020-21
N/A	- \$400,000	- \$200,000	- \$200,000

<u>Section</u>	<u>Section Title</u>
11025	Rollovers to ABLE Programs from 529 Programs

Background

Qualified ABLE Programs

The IRC provides for a tax-favored savings program intended to benefit disabled individuals, known as qualified ABLE programs.¹⁶⁹ A qualified ABLE program is a program established and maintained by a State or agency or instrumentality thereof. A qualified ABLE program must meet the following conditions: (1) under the provisions of the program, contributions may be made to an account (an “ABLE account”), established for the purpose of meeting the qualified disability expenses of the designated beneficiary of the account; (2) the program must limit a designated beneficiary to one ABLE account; and (3) the program must meet certain other requirements discussed below. A qualified ABLE program is generally exempt from income tax, but is otherwise subject to the taxes imposed on the unrelated business income of tax-exempt organizations.

A designated beneficiary of an ABLE account is the owner of the ABLE account. A designated beneficiary must be an eligible individual (defined below) who established the ABLE account and who is designated at the commencement of participation in the qualified ABLE program as the beneficiary of amounts paid (or to be paid) into and from the program.

Contributions to an ABLE account must be made in cash and are not deductible for federal income tax purposes. Except in the case of a rollover contribution from another ABLE account, an ABLE account must provide that it may not receive aggregate contributions during a taxable year in excess of the amount under IRC section 2503(b) (the annual gift tax exemption). For 2017, this

¹⁶⁹ IRC section 529A.

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is \$14,000.¹⁷⁰ Additionally, a qualified ABLE program must provide adequate safeguards to ensure that ABLE account contributions do not exceed the limit imposed on accounts under the qualified tuition program of the State maintaining the qualified ABLE program. Amounts in the account accumulate on a tax-deferred basis (*i.e.*, income on accounts under the program is not subject to current income tax).

A qualified ABLE program may permit a designated beneficiary to direct (directly or indirectly) the investment of any contributions (or earnings thereon) no more than two times in any calendar year and must provide separate accounting for each designated beneficiary. A qualified ABLE program may not allow any interest in the program (or any portion thereof) to be used as security for a loan.

Distributions from an ABLE account are generally includible in the distributee's income to the extent consisting of earnings on the account.¹⁷¹ Distributions from an ABLE account are excludable from income to the extent that the total distribution does not exceed the qualified disability expenses of the designated beneficiary during the taxable year. If a distribution from an ABLE account exceeds the qualified disability expenses of the designated beneficiary, a pro rata portion of the distribution is excludable from income. The portion of any distribution that is includible in income is subject to an additional 10-percent tax unless the distribution is made after the death of the beneficiary. Amounts in an ABLE account may be rolled over without income tax liability to another ABLE account for the same beneficiary ¹⁷² or another ABLE account for the designated beneficiary's brother, sister, stepbrother or stepsister who is also an eligible individual.

Except in the case of an ABLE account established in a different ABLE program for purposes of transferring ABLE accounts,¹⁷³ no more than one ABLE account may be established by a designated beneficiary. Thus, once an ABLE account has been established by a designated beneficiary, no account subsequently established by such beneficiary shall be treated as an ABLE account.

A contribution to an ABLE account is treated as a completed gift of a present interest to the designated beneficiary of the account. Such contributions qualify for the per-donee annual gift tax exclusion (\$14,000 for 2017) and, to the extent of such exclusion, are exempt from the generation skipping transfer ("GST") tax. A distribution from an ABLE account generally is not subject to gift tax or GST tax.

¹⁷⁰ This amount is indexed for inflation. In the case that contributions to an ABLE account exceed the annual limit, an excise tax in the amount of six percent of the excess contribution to such account is imposed on the designated beneficiary. Such tax does not apply in the event that the trustee of such account makes a corrective distribution of such excess amounts by the due date (including extensions) of the individual's tax return for the year within the taxable year.

¹⁷¹ The rules of section 72 apply in determining the portion of a distribution that consists of earnings.

¹⁷² For instance, if a designated beneficiary were to relocate to a different State.

¹⁷³ In which case the contributor ABLE account must be closed 60 days after the transfer to the new ABLE account is made.

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Eligible Individuals

As described above, a qualified ABLE program may provide for the establishment of ABLE accounts only if those accounts are established and owned by an eligible individual, such owner referred to as a designated beneficiary. For these purposes, an eligible individual is an individual either (1) for whom a disability certification has been filed with the Secretary for the taxable year, or (2) who is entitled to Social Security Disability Insurance benefits or SSI benefits¹⁷⁴ based on blindness or disability, and such blindness or disability occurred before the individual attained age 26.

A disability certification means a certification to the satisfaction of the Secretary, made by the eligible individual or the parent or guardian of the eligible individual, that the individual has a medically determinable physical or mental impairment, which results in marked and severe functional limitations, and which can be expected to result in death or which has lasted or can be expected to last for a continuous period of not less than 12 months, or is blind (within the meaning of section 1614(a)(2) of the Social Security Act). Such blindness or disability must have occurred before the date the individual attained age 26. Such certification must include a copy of the diagnosis of the individual's impairment and be signed by a licensed physician.¹⁷⁵

Qualified Disability Expenses

As described above, the earnings on distributions from an ABLE account are excluded from income only to the extent total distributions do not exceed the qualified disability expenses of the designated beneficiary. For this purpose, qualified disability expenses are any expenses related to the eligible individual's blindness or disability which are made for the benefit of the designated beneficiary. Such expenses include the following expenses: education, housing, transportation, employment training and support, assistive technology and personal support services, health, prevention and wellness, financial management and administrative services, legal fees, expenses for oversight and monitoring, funeral and burial expenses, and other expenses, which are approved by the Secretary under regulations and consistent with the purposes of section 529A.

Transfer to State

In the event that the designated beneficiary dies, subject to any outstanding payments due for qualified disability expenses incurred by the designated beneficiary, all amounts remaining in the deceased designated beneficiary's ABLE account not in excess of the amount equal to the total medical assistance paid such individual under any State Medicaid plan established under title XIX of the Social Security Act shall be distributed to such State upon filing of a claim for payment by such State. Such repaid amounts shall be net of any premiums paid from the account or by or on behalf of the beneficiary to the State's Medicaid Buy-In program.

¹⁷⁴ These are benefits, respectively, under Title II or Title XVI of the Social Security Act.

¹⁷⁵ No inference may be drawn from a disability certification for purposes of eligibility for Social Security, SSI or Medicaid benefits.

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Treatment of ABLE Accounts under Federal Programs

Any amounts in an ABLE account, and any distribution for qualified disability expenses, shall be disregarded for purposes of determining eligibility to receive, or the amount of, any assistance or benefit authorized by any federal means-tested program. However, in the case of the SSI program, a distribution for housing expenses is not disregarded, nor are amounts in an ABLE account in excess of \$100,000. In the case that an individual's ABLE account balance exceeds \$100,000, such individual's SSI benefits shall not be terminated, but instead shall be suspended until such time as the individual's resources fall below \$100,000. However, such suspension shall not apply for purposes of Medicaid eligibility.

New Federal Law (IRC section 529)

The provision allows for amounts from qualified tuition programs (also known as 529 accounts) to be rolled over to an ABLE account without penalty, provided that the ABLE account is owned by the designated beneficiary of that 529 account, or a member of such designated beneficiary's family.¹⁷⁶ Such rolled-over amounts count towards the overall limitation on amounts that can be contributed to an ABLE account within a taxable year.^{177 178} Any amount rolled over that is in excess of this limitation shall be includible in the gross income of the distributee in a manner provided by section 72.¹⁷⁹

Effective Dates

The provision applies to distributions after the date of enactment, December 22, 2017, and before January 1, 2026.

California Law (R&TC sections 17140 and 17140.4)

California conforms, under the PITL, to qualified tuition programs (also known as 529 accounts) under IRC section 529, as of the "specified date" of January 1, 2015,¹⁸⁰ with modifications, but does not conform to the rollover of 529 accounts to an ABLE account without penalty.

California conforms, under the PITL, relating to qualified ABLE programs and accounts under IRC section 529A, as of the "specified date" of January 1, 2015, with modifications, but does not conform to the rollover of 529 accounts to an ABLE account without penalty.

¹⁷⁶ For these purposes, a member of the family means, with respect to any designated beneficiary, the taxpayer's: (1) spouse; (2) child or descendant of a child; (3) brother, sister, stepbrother or stepsister; (4) father, mother or ancestor of either; (5) stepfather or stepmother; (6) niece or nephew; (7) aunt or uncle; (8) in-law; (9) the spouse of any individual described in (2)-(8); and (10) any first cousin of the designated beneficiary.

¹⁷⁷ 529A(b)(2)(B).

¹⁷⁸ 529(c)(3)(A).

¹⁷⁹ 529(c)(3)(A).

¹⁸⁰ R&TC section 17024.5.

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Impact on California Revenue

Estimated Conformity Revenue Impact of Rollovers to ABLE Programs from 529 Programs For Taxable Years Beginning On or After January 1, 2018 Enactment Assumed After June 30, 2018			
2017-18	2018-19	2019-20	2020-21
N/A	- \$450,000	- \$200,000	- \$200,000

<u>Section</u>	<u>Section Title</u>
11026	Treatment of Certain Individuals Performing Service in the Sinai Peninsula of Egypt

Background

Members of the Armed Forces serving in a combat zone are afforded a number of tax benefits. These include:

An exclusion from gross income of certain military pay received for any month during which the member served in a combat zone or was hospitalized as a result of serving in a combat zone;¹⁸¹

An exemption from taxes on death while serving in a combat zone or dying as a result of wounds, disease, or injury incurred while so serving;¹⁸²

Special estate tax rules where death occurs in a combat zone;¹⁸³

Special benefits to surviving spouses in the event of a service member's death or missing status;¹⁸⁴

An extension of time limits governing the filing of returns and other rules regarding timely compliance with Federal income tax rules;¹⁸⁵ and

An exclusion from telephone excise taxes.¹⁸⁶

New Federal Law (Uncodified Act Section 11026)

The provision grants combat zone tax benefits to the Sinai Peninsula of Egypt, if as of the date of enactment of the provision any member of the Armed Forces of the United States is entitled to special pay under section 310 of title 37, United States Code (relating to special pay; duty subject to hostile fire or imminent danger), for services performed in such location. This benefit lasts only during the period such entitlement is in effect but not later than taxable years beginning before January 1, 2026.

¹⁸¹ IRC section 112; see also, IRC section 3401(a)(1), exempting such income from wage withholding.

¹⁸² IRC section 692.

¹⁸³ IRC section 2201.

¹⁸⁴ IRC sections 2(a)(3) and 6013(f)(1).

¹⁸⁵ IRC section 7508.

¹⁸⁶ IRC section 4253(d).