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# SPECIAL REPORT: Fiscal Year 2006 Budget & Tax Reconciliation and California Implications

The House approved S. 1932 (H. Rpt. 109-362) on December 19, 2005 by a vote of 212-206. The bill was then amended in the Senate on December 21, 2005 and approved. On November 18, 2005, the Senate passed its Tax Reconciliation Bill, S. 2030, by a vote of 64-33; the House passed its version, the Tax Relief Extension Reconciliation Act of 2005 (H.R. 4297/H.Rpt. 109-304), on December 8 by a vote of 234-197. Action on a conference agreement on those bills was postponed until after Congress returned from the 2005-2006 winter break. Upon return, the House of Representatives approved the measure on February 1, 2006, by a vote of 216-214.

The following is a brief examination of the legislation from a California perspective, prepared by the California Institute. We apologize for errors or omissions in our discussion, and would appreciate any input or feedback on how to make improvements. The ordering of items generally reflects their appearance in the bill and does not imply relative importance.

**Welfare Reauthorization**

The Debt Reduction Act of 2005 accedes to House approved language for the reauthorization of welfare related grants.

The Temporary Assistance for Needy Families (TANF) block grant would be renewed and authorized for five years through 2010, under the most recent version of budget reconciliation. Funding for TANF would remain fixed at $16.6 billion annually. Conference bill language eliminates certain related grant programs including high-performance bonuses, and out-of-wedlock birth reduction rates. California receives roughly 22 percent of welfare grants, nationally.

Conference report language establishes new healthy marriage strengthening and responsible fatherhood promotion programs. An annual authorization of $150 million is provided to support competitive grants for related demonstration and research programs. Applicants must show how their initiatives will address issues of domestic violence, involve domestic violence experts, and support voluntary participation.

The House and White House plan to increase a TANF recipient's work demands from 30 to 40 hours per week, and mandate a work participation rate of 70 percent in each state appears to have

been dropped under the Conference proposal. The bill instead mandates a 50 percent state rate of participation requirement, using new enforcement regulations, and it would require 35 hours of work per week Failure to meet participation rate requirements will result in federal penalty of a 1 percent to 5 percent grant reduction (depending on the severity of the shortfall. According to the Center for Law and Social Policy (CLASP), only four states are projected to meet this standard. A CLASP analysis found California to have achieved a baseline TANF participation rate of 27 percent in 2003 and would need to verify work participation for 60,700 additional families to meet the new standard.

The Conference bill also makes revisions to the caseload reduction credit program, which awards supplemental grants to states experiencing the most significant declines in their TANF rolls since 1995. Under revised TANF language, caseload reductions will be compared to the average number of families receiving aid in 2005 (instead of 1995). Families counted toward this provision include those receiving federal welfare assistance as well as state-only welfare support to prevent states from shifting federal TANF recipients to state-only programs as a way of reducing caseloads.

Mandatory and matching child care authorizations are increased by $1.85 billion over five years under the budget reconciliation and debt reduction bill. California receives a more modest 11 percent share of child care grants.

**Student Loans**

Stafford loans are authorized beyond 2010 under the budget reconciliation conference plan. Changes to student loan mandatory spending results in a net savings of $12.7 billion. Most of the cuts come from increases in interest rates for borrowers and reduced federal subsidies to lenders. Some specific loan policy savings are achieved through eliminating government subsidies to lenders when loan interest rates fall below fair market rates, eliminating the 9.5 percent return on student loans received by certain lenders, shifting loan administration costs from mandatory spending accounts, reducing lender insurance reimbursements from 98 percent to 97 percent, and requiring that borrowers pay a mandatory loan insurance fee of 1 percent.

Some new costs are incurred by the conference agreement through the establishment of a new mandatory college grant program for low income students, the elimination of loan origination fees, loan cancellation benefits for math, science and special education teachers, deferments for active military personnel, loan repayment plan alignment, and increases to amounts students can borrow.

Loan maximum limits for college students are increased as follows:

First-year college: $2,625 to $3,500
Second-year college: $3,500 to $4,500
Graduate school: $10,000 to $12,000

Conference bill language eliminates the 50/50 rule prohibiting institutions that offer more than 50 percent of college courses online from having their share of student aid be reduced.

The bill establishes a $4.5 billion academic competitiveness grant program to benefit Pell Grant eligible college students in their 1st to 4th years of instruction. Students receiving grants must meet qualifications such as high grade point averages and completion of rigorous high school education. In addition, third and fourth year recipients must be declared math, science, engineering, computer science or critical foreign language majors before being eligible to receive grants. Supplemental grants range from $750 in year 1 to $4,000 in years 3 and 4. No student may receive more than their total cost of attendance, under proposed language. If funding for the competitiveness program is short, recipient students are required to have their grants ratably reduced. Funds for the program are to be phased in starting at $790 million in 2006 reaching $1 billion in 2010.

**Low income Home Energy Assistance Program (LIHEAP)**

This $2.2 billion program assists low income and elderly families with the cost of energy utilities. Funding for this program is currently contained in the Labor-HHS-Education FY 2006 appropriations measure. The overwhelming majority of LIHEAP grants are apportioned to states through a statutory formula established in the 1980s. LIHEAP provides a disproportionately low share of funding to California because its distribution formula is skewed to benefit colder states in the north and the east, rather than warmer ones in the west and south. California's $85.6 million FY 2005 allotment represented 4.6 percent of the national LIHEAP formula grant total.

Once appropriated funding for the formula segment of the program exceeds a certain threshold, a different formula apportionment system is triggered which directs a slightly higher share of the national total (6.25%) to California. The formula trigger has not been activated since the 1980s, however proposed FY 2006 appropriations would meet the necessary threshold to activate the revised formula.

The budget reconciliation bill appropriates an additional $1 billion in LIHEAP grants to be made available in FY 2007, however only $250 million of those funds would be assigned to the formula account, whereas $750 million would be made available for emergency LIHEAP allocations. If LIHEAP appropriations for FY 2007 remain consistent with FY 2006, then the formula trigger would again be activated, and California would benefit from a higher share of the overall pot. However, California's revised share of the LIHEAP total is not likely to exceed 7.9 percent of total appropriations, far below California's share of persons in poverty. The state may improve its energy assistance returns through a change to LIHEAP's formula distribution system, or an effort to shift LIHEAP dedicated funds to other social assistance programs, which would provide California with a more equitable share of total dollars.

**Tax Provisions**

Both the House and Senate passed tax bills contain identical provisions extending the Research and Development tax credit for one year to December 31, 2006, as well as extending other expiring credits such as the Welfare-to-Work credit and the Work Opportunity Tax credit that are set to expire at the end of the year. The R&D tax credit provision also increases the value of the alternative incremental credit and adds a new alternative simplified credit.

The House reconciliation tax bill (H.R. 4297) also extends for two years (to 2010) the lower tax rates currently imposed on capital gains and dividends. The Senate dropped those provisions from its version of the bill (S.2030). H.R. 4297 also allows taxpayers to deduct up to $4,000 (depending on income) of higher education expenses in lieu of claiming the Hope or Lifetime Learning tax credits. The deduction is available "above-the-line," meaning it may be claimed by all individual taxpayers regardless of whether they itemize their deductions.

According to data from the Tax Foundation, California taxpayers would benefit somewhat more than the national average from a dividend tax exclusion. Whereas the percentage of returns in 2000 showing dividend income was nearly identical (26.2% in the U.S.; 26.3% in California), the total amount of such income was enough that Californians would receive more than 14 percent of total tax relief under an exclusion, according to data available at http://www.taxfoundation.org/publications/show/1243.html .

**Medicaid Citizenship Requirements**

The budget bill requires the nation's 50 million Medicaid recipients to present a passport or birth certificate to be eligible for Medicaid. The program, which provides federal- and state-supported health insurance coverage for persons in or near poverty, would require the additional citizenship documentation beginning in July 2006.

The goal of the provision is to prevent undocumented immigrants from enrolling in Medicaid. The Congressional Budget Office estimates the citizenship documentation requirement will save the government $735 million over 10 years, owing to reductions in the number of program enrollees due to improper or insufficient paperwork. Advocates of the provision argue that fraudulent and illegal use of Medicaid to pay for health care services for illegal immigrants costs the nation and states hundreds of millions of dollars. A recent study by the Center for Immigration Studies found that 15 percent of the nation's uninsured population are illegal immigrants (27 percent in California), and that 56 percent of illegals and their U.S.-born children nationwide are uninsured (54 percent in California).

Critics of the Medicaid citizenship requirement provision argue that it creates burdens for elderly U.S. citizens who might not have a birth certificate or passport, or might be unable to locate the documents. Advocates for immigrants and the foreign born are not the only critics – the Leadership Conference on Civil Rights, a coalition of civil rights groups, said the measure "raises significant civil rights concerns" because it discriminates against older African Americans in the South. They cite a study showing that as many as one in five African Americans born around 1940 lack a birth certificate because racial discrimination denied mothers access to hospitals.

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For additional information and a detailed analysis of the budget reconciliation bill, including estimates of the fiscal impact on the State of California, see a report from the State's Legislative Analysts's office at http://www.lao.ca.gov/ .