HB 18-1221

Legislative Council Staff
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FISCAL NOTE

Drafting Number:	LLS 18-0869	**Date:**	March 2, 2018
Prime Sponsors:	Rep. Leonard Sen. Neville T.	**Bill Status:**	House Education
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Bill Topic: INCOME TAX DEDUCTION FOR 529 ACCOUNT K-12 EXPENSES

Summary of Fiscal Impact:

☒ State Revenue
☒ State Expenditure *(indeterminate)*
☐ State Transfer
☐ TABOR Refund
☐ Local Government
☒ Statutory Public Entity

This bill modifies the state income tax deduction for 529 account contributions, eliminating income tax recapture if moneys are disbursed from a 529 account for K-12 education purposes. It reduces state revenue and indeterminately reduces state expenditures on an ongoing basis.

Appropriation Summary: No appropriation is required.

Fiscal Note Status: This fiscal note reflects the introduced bill.

Table 1
State Fiscal Impacts Under HB 18-1221

		FY 2017-18 *current year*	FY 2018-19	FY 2019-20
Revenue	General Fund	($0.3 million to $1.2 million)	($4 million to $15 million)	($4 million to $15 million)
Expenditures		-	-	-
Transfers		-	-	-

Summary of Legislation

This bill modifies the state income tax deduction for contributions to an education savings account established under section 529 of the Internal Revenue Code (529 account) to incorporate changes to federal tax law enacted in the Tax Cuts and Jobs Act of 2017 (TCJA). The bill clarifies that contributions to a 529 account for qualified kindergarten through twelfth grade (K-12) education expenses qualify for the state deduction. Further, the bill requires that disbursements from 529 accounts for K-12 expenses not be subject to income tax recapture.

Background

Current state deduction. Current state law allows a taxpayer annually to deduct up to $10,000 in 529 account contributions from state taxable income. Taxpayers are allowed to spend money from their 529 accounts for "qualified higher education expenses," as defined under a particular section in federal law, or as a result of the beneficiary student's death or disability or receipt of a scholarship. Disbursements that do not fit one of these purposes are subject to income tax recapture, meaning that taxpayers who make these disbursements must pay income tax on the amount disbursed, plus penalty and interest. Colorado 529 accounts are managed by CollegeInvest, a state enterprise administered through the Department of Higher Education.

Federal deduction. Federal law allows for investment income earned in a 529 account to be deducted for federal tax purposes.

Tax Cuts and Jobs Act. President Trump signed the TCJA into federal law on December 22, 2017. The TCJA amends section 529 to broaden the types of expenses that qualify for the federal deduction. Specifically, the TCJA broadens "qualified higher education expenses" to include expenses for an elementary or secondary public, private, or religious school; for tuition for tutoring or educational classes outside the home; for dual enrollment with a higher education institution; and for educational therapies for students with disabilities in connection with a home school.

The implications of the TCJA on the state deduction are a matter of ongoing legal consideration. According to an Office of Legislative Legal Services (OLLS) legal memorandum dated February 27, 2018, 529 account contributions for K-12 expenses and for the other expenses added in the TCJA are eligible for the deduction; however, 529 account disbursements for these purposes are subject to income tax recapture, including penalty and interest.

Assumptions

Current law. This fiscal note assumes that current law will be administered in a manner conforming to the February 27, 2018, OLLS memorandum. Accordingly, under current law, 529 account contributions for K-12 expenses and other purposes authorized in the TCJA are assumed to qualify for the state deduction. However, taxpayers making 529 account disbursements for these purposes are assumed to be subject to income tax recapture, including penalty and interest obligations.

Because taxpayers who claim the income tax deduction under current law are assumed to be subject to recapture, the number of taxpayers who will deduct 529 account contributions that they intend to use for K-12 expenses is assumed to be minimal.

House Bill 18-1221. Due to the tax deduction in this bill, taxpayers who pay for tuition at a private K-12 school, or who pay for any of the other federally eligible expenses added under the TCJA, will have an incentive to deposit up to $10,000 annually in a 529 account even if their contributions will not remain in the account long enough to accrue substantial interest. For example, a taxpayer who pays K-12 tuition of $10,000 will receive a tax benefit worth $463 by depositing income of $10,000 in a 529 account, even if this money accrues no interest at all. For this reason, this bill is assumed to motivate taxpayers to utilize 529 accounts even if they receive no federal tax benefit for doing so. Further, because tax benefits can be achieved during the same year for which qualified expenses are paid, this fiscal note assumes no lag time between 529 account contributions and disbursements.

State Revenue

The bill is estimated to reduce General Fund revenue by between $0.3 million and $1.2 million in the current FY 2017-18 and between $4.0 million and $15.0 million in FY 2018-19, FY 2019-20, and subsequent fiscal years. The estimates for FY 2017-18 represent a one-month impact for June 2018 on an accrual accounting basis based on the bill's assumed effective date.

Upper bound estimate. The upper bound estimate of the revenue reduction is $1.2 million in the current FY 2017-18 and $15.0 million annually beginning in FY 2018-19. These amounts assume that deductions will be taken for all students enrolled in private and religious K-12 schools, between 37,000 and 39,000 students annually. The deduction amount is assumed to average approximately $8,000 for kindergarten through eighth grade students, the average amount of private elementary school tuition, and $10,000 for ninth through twelfth grade students, based on the assumption that average private high school tuition exceeds $10,000 per year.

Lower bound estimate. The lower bound estimate of the revenue reduction is $0.3 million in the current FY 2017-18 and $4.0 million annually beginning in FY 2018-19. These amounts assume that deductions will be taken for about one-third of students enrolled in private K-12 education, based on the share of disbursements made for higher education expenses, and that the deduction amount will average about $6,500 annually, consistent with average higher education disbursements.

For the purposes of both estimates, the revenue impact of deductions for expenses qualifying under the TCJA other than private school tuition is expected to be less than $1 million annually.

TABOR Impact

The bill decreases state income tax revenue subject to TABOR beginning in the current FY 2017-18. State revenue is not currently expected to exceed the TABOR limit through at least FY 2019-20 and no refund is required. Therefore, the bill is not expected to impact TABOR refunds in these years. However, refunds in future years when the state next collects a TABOR surplus will be reduced.

State Expenditures

This bill is expected to decrease General Fund expenditures by an indeterminate amount beginning in FY 2018-19. This bill eliminates the recapture requirement for qualifying K-12 education expenses, reducing workload in the Taxation and Compliance Division and expenditures for personal services, operating expenses, and leased space.

Preliminary estimates from the department suggest that this bill reduces General Fund expenditures by up to $209,241 and 4.3 FTE when fully implemented. These estimates assume that deductions would be claimed for 529 account contributions for all Colorado private K-12 students, requiring recapture in every case. The actual amount by which expenditures are reduced will depend on the number of taxpayers who claim an income tax deduction even though this amount will eventually be subject to recapture, penalty, and interest. If no taxpayers claim the deduction for these contributions, the bill has no impact on departmental expenditures.

Appropriations for workload to implement changes under the TCJA were not included in the 2017 Long Bill, the department's FY 2017-18 supplemental appropriations bill, or the Governor's FY 2018-19 budget request. Accordingly, this bill's reduction in General Fund expenditures does not require a reduction in base departmental appropriations for FY 2018-19.

Statutory Public Entity

The bill is expected to increase the number of 529 accounts managed by CollegeInvest, the amount of income deposited in accounts, and the amount of disbursements. Under the upper bound estimate, the number of accounts is expected to increase by approximately 38,000, and the amount of contributions is expected to increase by approximately $325 million, during FY 2018-19. Under the lower bound estimate, the number of accounts is expected to increase by 12,000, and the amount of contributions is expected to increase by approximately $100 million.

For informational purposes, as of January 31, 2018, CollegeInvest managed 351,052 accounts and $8.16 billion in assets.

Effective Date

The bill takes effect upon signature of the Governor, or upon becoming law without his signature.

State and Local Government Contacts

Education	Higher Education	Information Technology
Law	Revenue	