HB 18-1221

Legislative Council Staff

Nonpartisan Services for Colorado's Legislature

FINAL FISCAL NOTE

Drafting Number:	LLS 18-0869	**Date:**	September 6, 2018
Prime Sponsors:	Rep. Leonard Sen. Neville T.	**Bill Status:**	Postponed Indefinitely
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Bill Topic: INCOME TAX DEDUCTION FOR 529 ACCOUNT K-12 EXPENSES

Summary of Fiscal Impact:

☒ State Revenue
☒ State Expenditure
☐ State Transfer
☒ TABOR Refund
☐ Local Government
☐ Statutory Public Entity

This bill would have modified 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 would have increased state revenue and state expenditures on an ongoing basis.

Appropriation Summary: No appropriation is required.

Fiscal Note Status: This fiscal note reflects the introduced bill. This bill did not become law; therefore, the impacts identified in this analysis do not take effect.

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)
	Cash Funds*	$8.3 million to $27.1 million	$100 million to $325 million	$100 million to $325 million
	Total	**$8.0 million to $25.9 million**	**$96 million to $310 million**	**$96 million to $310 million**
Expenditures	General Fund	-	-	-
	Cash Funds*	$8.3 million to $27.1 million	$100 million to $325 million	$100 million to $325 million
	Total	**$8.3 million to $27.1 million**	**$100 million to $325 million**	**$100 million to $325 million**
Transfers		-	-	-
TABOR Refund	General Fund	-	($4 million to $15 million)	($4 million to $15 million)

**These amounts represent changes to CollegeInvest savings account contributions and disbursements.*

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

This bill is expected to increase state revenue by between $8.0 million and $25.9 million in the current FY 2017-18 and by between $96 million and $310 million in FY 2018-19, FY 2019-20, and subsequent fiscal years. The estimates for FY 2017-18 represent a one-month impact based on the bill's assumed effective date.

The bill is expected to increase contributions to savings accounts managed by CollegeInvest, a state enterprise, and to decrease General Fund revenue from income taxes. The bill's revenue impacts under two scenarios are presented in Table 2. These two scenarios are described below.

Table 2
State Revenue under House Bill 18-1221

	FY 2017-18 *current year*	FY 2018-19	FY 2019-20
Upper Bound Estimate			
529 Account Contributions	$27.1 million	$325.0 million	$325.0 million
General Fund Income Tax Revenue	($1.2 million)	($15.0 million)	($15.0 million)
Upper Bound Total	**$25.9 million**	**$310.0 million**	**$310.0 million**
Lower Bound Estimate			
529 Account Contributions	$8.3 million	$100.0 million	$100.0 million
General Fund Income Tax Revenue	($0.3 million)	($4.0 million)	($4.0 million)
Lower Bound Total	**$8.0 million**	**$96.0 million**	**$96.0 million**

Upper bound estimate. The upper bound estimates assume that 529 account contributions will be made, and income tax deductions will be taken, for all students enrolled in private and religious K-12 schools, between 37,000 and 39,000 students annually. The contribution and deduction amount is assumed to average about $8,000 for kindergarten through eighth grade students, an amount equal to average 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 estimates assume that 529 account contributions will be made, and income tax 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. The contribution and deduction amount is assumed to 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. For informational purposes, as of January 31, 2018, CollegeInvest managed 351,052 accounts and $8.16 billion in assets.

TABOR Impact

This bill reduces state income tax revenue, which will reduce the amount of money required to be refunded under TABOR by between $4.0 million and $15.0 million in each of FY 2018-19 and FY 2019-20. Contributions to CollegeInvest savings accounts are not subject to TABOR because CollegeInvest is a state enterprise. Since the bill reduces revenue to the General Fund and the refund obligation by equal amounts, there is no net impact on the amount of money available in the General Fund for the budget. However, the bill will reduce money for the General Fund budget in the future during years when the state does not collect revenue above the TABOR limit.

The state is not expected to collect a TABOR surplus during the current FY 2017-18. State revenue subject to TABOR is not estimated for years beyond FY 2019-20.

State Expenditures

The bill is expected to increase 529 account disbursements by between $8.3 million and $27.1 million during the current FY 2017-18, and by between $100 million and $325 million annually beginning in FY 2018-19. General Fund expenditures for the Department of Revenue will decrease by an indeterminate amount beginning in FY 2018-19.

CollegeInvest. Parents and guardians of students attending private school are expected to increase their contributions 529 accounts administered by CollegeInvest. The disbursements estimated are equal to the contributions estimated in the State Revenue section of this fiscal note and may shift across fiscal years. State workload to administer new savings accounts will also increase. It is expected that this workload increase can be accomplished within existing appropriations.

Department of Revenue. 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 2018 Long Bill. Accordingly, this bill's reduction in General Fund expenditures does not require a reduction in base departmental appropriations for FY 2018-19.

Effective Date

The bill was postponed indefinitely by the House Education Committee on March 26, 2018.

State and Local Government Contacts

Education	Higher Education	Information Technology
Law	Revenue	