SB 19-257

Legislative Council Staff

Nonpartisan Services for Colorado's Legislature

FINAL FISCAL NOTE

Drafting Number:	LLS 19-1102	**Date:**	June 12, 2019
Prime Sponsors:	Sen. Pettersen Rep. Buentello; Cutter	**Bill Status:**	Deemed Lost
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Bill Topic: PROTECT COLLEGEINVEST

Summary of Fiscal Impact:

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

This bill modifies the state income tax deduction for 529 account contributions to exclude contributions intended to be used for K-12 education purposes. It minimally reduces state tax revenue, college savings account contributions, and workload for administration on an ongoing basis.

Appropriation Summary: No appropriation is required.

Fiscal Note Status: This fiscal note reflects the reengrossed bill. The bill was not enacted into law; therefore, the impacts identified in this analysis do not take effect.

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) in response to 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 that are intended to be used for kindergarten through twelfth grade (K-12) education expenses do not qualify for the state deduction. The current law requirement that disbursements from a 529 account for reasons other than for qualified education expenses be subject to income tax recapture is amended to instead require such disbursements to be added to a taxpayer's Colorado taxable income in the year when they are made. Definitions in state law that reference section 529 are amended to reference the section as it existed prior to the enactment of the TCJA.

CollegeInvest is required to provide the Department of Revenue with available information related to 529 account disbursements that are not used to pay qualified higher education expenses.

Background

Current state deduction. Current state law allows a taxpayer annually to deduct 529 account contributions when computing their state taxable income. Taxpayers are allowed to spend money from 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. Enacted in December 2017, the TCJA amends section 529 to broaden the types of expenses that qualify for the federal deduction. Specifically, the TCJA broadens the deduction 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 state 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 consistent with 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.

Senate Bill 19-257. This bill modifies the state deduction to exclude 529 account contributions intended to be disbursed for K-12 expenses. Because these contributions would be subject to income tax recapture at the time of their disbursement under current law, the bill is assumed not to narrow tax benefit eligibility or to reduce the net tax benefit allowed to taxpayers who use their 529 accounts for K-12 purposes. However, the bill is assumed to reduce the likelihood that taxpayers will deduct these contributions. In the event that deductions are made, the bill requires that subsequent disbursements be added to Colorado taxable income rather than subjected to recapture, eliminating tax penalty and interest that would otherwise be collected.

State Revenue

Based on the assumptions in the previous section, this bill is assessed on net as minimally reducing General Fund revenue from income tax penalty and interest, beginning in FY 2019-20. The bill will also minimally reduce contributions to 529 accounts managed by CollegeInvest.

College savings accounts. The bill is expected to minimally reduce the number of 529 accounts managed by CollegeInvest, the amount of income deposited in accounts, and the amount of disbursements. Savings account activity will decrease only to the extent that taxpayers reduce their use of 529 accounts. Affected taxpayers may still be able to access a federal tax benefit by using their 529 account for K-12 expenses, reducing the expected impact.

Income tax. The bill decreases tax penalty and interest revenue only in cases where taxpayers who would have claimed the income tax deduction under current law are unable or less likely to do so as a result of the bill's enactment. The affected taxpayer population and the amount of the revenue impact are each assumed to be minimal.

State Expenditures

This bill minimally reduces workload to conduct income tax recapture in the Department of Revenue's Tax Audit and Compliance Division, and minimally increases workload in CollegeInvest, beginning in FY 2019-20.

Department of Revenue. Preliminary estimates from the department suggest that General Fund expenditures for recapture would total $209,241 and 4.3 FTE if deductions were claimed for 529 account contributions for all Colorado private K-12 students, requiring recapture in every case. The actual amount of deductions is expected to be significantly lower as explained in the Assumptions section. Further, the bill impacts workload only to the extent that it reduces income tax deductions for 529 account contributions that subsequently would be subject to recapture under current law. The affected taxpayer population and the amount of the workload impact are each assumed to be minimal.

The bill modifies the income tax deduction for 529 account contributions to exclude contributions intended to be used for K-12 purposes. The department is assumed not to be able to investigate a taxpayer's intent when making a 529 account contribution, so this provision of the bill is assessed as a statutory clarification that does not increase departmental workload or expenditures.

CollegeInvest. The bill increases workload for CollegeInvest to furnish information to the Department of Revenue regarding 529 account disbursements that would trigger an addition to state taxable income under the bill. This workload increase is assumed to be minimal and can be accomplished within the agency's existing resources.

Effective Date

The bill was deemed lost on second reading in the House of Representatives.

State and Local Government Contacts

Higher Education Law Revenue