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FISCAL NOTE

Drafting Number:	LLS 19-0615	Date:	January 30, 2019
Prime Sponsors:	Rep. Larson Sen. Smallwood	Bill Status:	House Education
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Bill Topic: INCOME TAX DEDUCTION FOR 529 ACCOUNT K-12 EXPENSES

Summary of Fiscal Impact:

<input checked="" type="checkbox"/> State Revenue	<input checked="" type="checkbox"/> TABOR Refund
<input checked="" type="checkbox"/> State Expenditure	<input type="checkbox"/> Local Government
<input type="checkbox"/> State Transfer	<input type="checkbox"/> Statutory Public Entity

This bill modifies the state income tax deduction for 529 account contributions, eliminating the income tax recapture requirement if moneys are withdrawn from a 529 account for K-12 education purposes. It decreases state revenue and decreases 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 19-1123

		FY 2019-20	FY 2020-21
Revenue	General Fund	(\$3.1 million)	(\$3.4 million)
Expenditures		-	-
Transfers		-	-
TABOR Refund	General Fund	(\$3.1 million)	-

**Omits fiscal impacts affecting private 529 college savings accounts managed by CollegeInvest, a state enterprise.*

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). The bill allows money in a 529 account to be withdrawn to pay for qualified kindergarten through twelfth grade (K-12) education expenses, including those for enrollment or attendance at a public, private, or religious school, and requires that such withdrawals not be subject to state 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. Withdrawals that do not fit one of these purposes are subject to income tax recapture, meaning that taxpayers who make these withdrawals must pay income tax on the amount withdrawn, plus penalty and interest. Colorado 529 accounts are managed by CollegenInvest, 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. The Tax Cuts and Jobs Act (TCJA) became law in December 2017. It 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.

According to an Office of Legislative Legal Services (OLLS) legal memorandum dated February 27, 2018, 529 account contributions for K-12 expenses and for other expenses added in the TCJA are eligible for the state deduction; however, 529 account withdrawals for these purposes are subject to income tax recapture, including penalty and interest. Expenditures for additional income tax recapture associated with this provision of the TCJA are not included in FY 2018-19 appropriations to the Department of Revenue (DOR), in DOR's FY 2018-19 supplemental request, or in DOR's FY 2019-20 budget request.

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, 529 account contributions for K-12 expenses are assumed to qualify for the state deduction. However, taxpayers making 529 account withdrawals for these purposes are assumed to be subject to income tax recapture, including penalty and interest. Expenditures required for the DOR to administer this obligation in future years have not been estimated and are currently assessed as indeterminate.

House Bill 19-1123. Taxpayers who pay tuition at a private K-12 school are assumed to have an incentive to deposit up to \$10,000 annually in a 529 account, even if their contributions will not remain 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. For this reason, this bill is assumed to incentivize taxpayers to use 529 accounts even if they receive no federal tax benefit. Further, because tax benefits can be accessed during the same year for which qualified expenses are paid, this fiscal note assumes no lag time between 529 account deposits and withdrawals.

State Revenue

The bill is expected to decrease General Fund revenue by \$3.1 million in FY 2019-20 and by \$3.4 million in FY 2020-21 and subsequent fiscal years. The estimate for FY 2019-20 reflects the bill's August 2, 2019, effective date. The bill reduces individual income tax revenue, which is subject to TABOR.

General Fund. The bill reduces income tax revenue by eliminating a current law income tax recapture requirement for 529 account withdrawals for K-12 education, and by providing an income tax benefit to taxpayers who make 529 account contributions that they intend to withdraw for K-12 education purposes. This bill assumes that accounts will be utilized for approximately 11,000 K-12 students per year, for whom 529 account contributions will be made in amounts averaging \$6,650 annually. The population estimate assumes that accounts will be used for 31.5 percent of Colorado's 34,550 private school students, consistent with the share of college students for whom accounts are used. The estimated amount deducted is consistent with account disbursements for higher education.

529 accounts. Table 1 does not present the bill's impact on revenue collected in 529 accounts because this revenue is not available for appropriation or expenditure by any state agency. Consistent with the General Fund revenue estimates in the previous paragraph, the bill is expected to increase funds contributed to 529 accounts by \$73.2 million annually when fully implemented.

State Expenditures

The bill decreases General Fund expenditures for tax administration because DOR will no longer be required to initiate income tax recapture when withdrawals from 529 accounts are made for K-12 education purposes. The impact on expenditures will occur in future years on an ongoing basis and is assessed as indeterminate.

529 accounts. Table 1 does not present the bill's impact on expenditures paid from 529 accounts because these expenditures are not made for any state program. Consistent with the General Fund revenue estimates in the previous section, the bill is expected to increase withdrawals from 529 accounts by \$73.2 million annually when fully implemented.

TABOR refunds. The bill is expected to decrease state General Fund obligations for TABOR refunds by \$3.1 million in FY 2019-20. Under current law and the December 2018 forecast, the bill will correspondingly reduce the amount refunded to taxpayers via sales tax refunds on income tax returns for tax year 2020. The state is not expected to collect a TABOR surplus in FY 2020-21. An estimate of state revenue subject to TABOR is not available for fiscal years beyond FY 2020-21.

Effective Date

The bill takes effect August 2, 2019, if the General Assembly adjourns on May 3, 2019, as scheduled, and no referendum petition is filed.

State and Local Government Contacts

Education
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