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FISCAL NOTE

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Prime Sponsors: Rep. Pettersen; Garnett Bill Status: House Education
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Bill Topic: NO 529 ACCOUNT INCOME TAX DEDUCTION FOR K-12 EXPENSES

- 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 revenue and workload for tax administration on an ongoing basis.

Appropriation Summary: No appropriation is required.

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

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).

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.

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 18-1209.** This bill modifies the deduction to exclude 529 account contributions intended eventually 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. The bill is assumed to further reduce the likelihood that taxpayers will deduct these moneys and then pay tax, penalty, and interest upon recapture.

## 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 the FY 2018-19.

The bill impacts 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.

## **TABOR Impact**

The bill minimally decreases state revenue subject to TABOR beginning in FY 2018-19. State revenue is not currently expected to exceed the TABOR limit in FY 2018-19 or FY 2019-20 and no refund is required. Therefore, the bill is not expected to impact TABOR refunds for these years. However, refunds in future years when the state next collects a TABOR surplus will be reduced.

## **State Expenditures**

This bill minimally reduces workload to conduct income tax recapture in the Department of Revenue's Tax Audit and Compliance Division beginning in FY 2018-19.

Preliminary estimates from the department suggest that General Fund expenditures for recapture would total up to \$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 are later subject to recapture at the time of their disbursement. 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.

## **Statutory Public Entity**

The bill is expected to minimally reduce the number of 529 accounts managed by CollegenInvest, 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 in order to attempt to access a state tax benefit. As explained in the Assumptions section of this fiscal note, this population is assumed to be minimal. Additionally, affected taxpayers may be able to access a federal tax benefit using their 529 account even under the bill, further reducing the impact expected.

## **Effective Date**

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

**State and Local Government Contacts**

Education  
Law

Higher Education  
Revenue

Information Technology