

INCOME TAX CREDIT FOR EMPLOYER 529 CONTRIBUTIONS



EVALUATION SUMMARY

APRIL 2020
2020-TE12

THIS EVALUATION WILL BE INCLUDED IN COMPILATION REPORT SEPTEMBER 2020

YEAR ENACTED	2018
REPEAL/EXPIRATION DATE	January 1, 2022
REVENUE IMPACT	\$81,000
NUMBER OF TAXPAYERS	83
AVERAGE TAXPAYER BENEFIT	\$976
IS IT MEETING ITS PURPOSE?	Yes, to a limited extent

WHAT DOES THIS TAX EXPENDITURE DO?

The Income Tax Credit for Employer 529 Contributions (529 Credit) [Section 39-22-539, C.R.S.] allows Colorado employers who make contributions to a qualified tuition plan owned by an employee to take a credit against their Colorado state income tax liability equal to 20 percent of the total contributions made, up to \$500 per employee who receives a contribution.

WHAT IS THE PURPOSE OF THIS TAX EXPENDITURE?

According to statute [Section 39-22-539(1), C.R.S], the purpose of the 529 Credit is to provide an incentive for employers to make contributions to their employees' qualified tuition plan accounts.

WHAT DID THE EVALUATION FIND?

We determined that the 529 Credit is meeting its purpose, to a limited extent, because some eligible businesses are making contributions to their employees' qualified tuition accounts under the program and the credit appears to be a significant factor in employers' decisions to offer contributions.

WHAT POLICY CONSIDERATIONS DID THE EVALUATION IDENTIFY?

We did not identify any policy considerations related to this tax expenditure.

INCOME TAX CREDIT FOR EMPLOYER 529 CONTRIBUTIONS

EVALUATION RESULTS

WHAT IS THE TAX EXPENDITURE?

Section 529 of the Internal Revenue Code allows individuals to save funds for education expenses using qualified tuition program savings accounts (529 accounts) sponsored by states, state agencies, or educational institutions. Individuals' 529 account contributions and distributions, including any investment income earned from the account, are generally not taxable for federal or Colorado tax purposes as long as any funds distributed from the account are used for qualified education expenses, such as tuition, fees, books, supplies, and equipment at a qualified educational institution. Additionally, taxpayers can deduct the amount that they contribute to a 529 account from their state taxable income in Colorado; this deduction is not available for federal tax purposes. Individuals typically use 529 accounts to save for the education expenses of their child or another family member. In Colorado, 529 accounts are administered by CollegeInvest, a state enterprise within the Colorado Department of Higher Education.

The Income Tax Credit for Employer 529 Contributions (529 Credit) [Section 39-22-539, C.R.S.] allows Colorado employers who make contributions to their employees' 529 accounts to take a credit against their state income tax liability equal to 20 percent of the total contributions made, capped at \$500 for each employee who receives a contribution. The credit is not refundable, but may be carried forward for up to 3 years. This tax expenditure was created in 2018 by House Bill 18-1217 and was first available to taxpayers beginning in Tax Year 2019. It was originally scheduled to expire on January 1, 2022. However, House Bill 20-1109, which was introduced during the 2020 legislative session and awaiting final legislative action at the time of our review, would extend its expiration date to January 1, 2032.

To claim the credit, taxpayers must first register online with CollegeInvest, which is responsible for tracking employers' contributions to employees' 529 accounts and reporting the contribution amounts to the Department of Revenue. Employers must then file Department of Revenue Form DR 0289, which is used to calculate the value of the 529 Credit. Taxpayers then claim the credit on their income tax form (DR 104 for individuals, DR 106 for partnerships and s-corporations, and DR 112 for c-corporations).

WHO ARE THE INTENDED BENEFICIARIES OF THE TAX EXPENDITURE?

Based on statute [Section 39-22-539(1), C.R.S.], the intended beneficiaries of the 529 Credit are employers that make contributions to their employees' qualified tuition plans and the employees who receive the contributions. The credit benefits employers by reducing their tax liability and may allow them to offer more attractive benefit packages to help attract and retain employees, who can use the amount contributed by employers to pay for education expenses.

WHAT IS THE PURPOSE OF THE TAX EXPENDITURE?

According to statute [Section 39-22-539(1), C.R.S.], the purpose of the 529 Credit is "to provide an incentive for employers to help their employees enhance education savings goals by contributing directly to the employees' qualified state tuition program accounts administered by [C]ollege[I]nvest."

IS THE TAX EXPENDITURE MEETING ITS PURPOSE AND WHAT PERFORMANCE MEASURES WERE USED TO MAKE THIS DETERMINATION?

We determined that the 529 Credit is meeting its purpose, to a limited extent, because some eligible businesses are making contributions to their employees' 529 accounts.

Statute does not provide quantifiable performance measures for this tax expenditure. Therefore, we created and applied the following

performance measure to determine the extent to which the credit is meeting its purpose:

PERFORMANCE MEASURE: *To what extent has the credit incentivized employers to make contributions to their employees' 529 accounts?*

RESULT: Based on our review of CollegeInvest data, we found that 83 businesses made contributions totaling \$435,000 to 270 employees' 529 accounts in Tax Year 2019, the first year the credit was available. Because this is a new credit, its usage may increase as more businesses become aware of it and add it to their employee benefit packages. CollegeInvest staff reported that one factor that may have limited employers' use of the credit was the initial 3-year sunset, which may have discouraged some businesses from participating because they did not want to add 529 contributions as an employee benefit when its long-term availability was uncertain. As discussed, this issue may be addressed by House Bill 20-1109, which was introduced, but still awaiting final legislative action at the time of our review, and would extend the expiration of the credit to January 1, 2032.

In addition, it appears that the 529 Credit was a significant influencing factor for participating employers when determining whether to offer 529 account contributions as an employee benefit. Specifically, to assess the extent to which the availability of the credit incentivized employers to make contributions to their employees' 529 accounts, we surveyed employers that had registered with CollegeInvest to make contributions qualifying for the credit and received 18 responses. All 18 participating employers who responded indicated that they had not offered contributions to employee 529 accounts prior to the availability of the credit and 15 (83 percent) indicated that the credit was completely or substantially responsible for their decision to begin offering 529 account contributions to employees.

WHAT ARE THE ECONOMIC COSTS AND BENEFITS OF THE TAX EXPENDITURE?

We estimate that the 529 Credit will have a revenue impact to the State

of about \$81,000 in foregone revenue for Tax Year 2019 and an equivalent tax savings for participating businesses. We based this estimate on CollegeInvest data showing that \$435,000 in eligible contributions were made in Tax Year 2019, of which \$404,000 was under the \$500 per employee cap. We multiplied this amount by 20 percent (the credit amount available based on statute) to arrive at our estimate. Because it is possible that not all of the businesses that made contributions will have sufficient tax liability to claim the full value of credits, the revenue impact may be less than this amount; however, we lacked information on the credit's usage because taxpayers had not yet filed complete income tax returns for Tax Year 2019 at the time of our review. On the other hand, the revenue impact could grow in future years as more employers become aware of the credit.

In addition, the 529 Credit appears to encourage employees to save more in their 529 accounts. Specifically, employers contributed an average of \$1,600 to 270 employees' accounts in Tax Year 2019, which compares to the average annual individual contributions to all CollegeInvest 529 accounts of \$400. CollegeInvest staff indicated that employers often structure their 529 contributions as matching contributions, for which employees must contribute to their accounts in order to receive the employers' contributions. Therefore, employees participating in the program may have been incentivized to save substantially more than they would have if the 529 Credit was not available.

WHAT IMPACT WOULD ELIMINATING THE TAX EXPENDITURE HAVE ON BENEFICIARIES?

If the 529 Credit was repealed, businesses that continue to make contributions to their employees' 529 accounts would experience an average increase of \$976 in their tax liabilities, based on the average benefit the 83 participating businesses received in Tax Year 2019. In the absence of the credit, it is also likely that at least some of the businesses that currently offer matching contributions to their employees would no longer offer them, which could make it harder for some Coloradans to save for education expenses. Of the 18 employers who are currently participating and responded to our survey, 50 percent indicated that

they would likely no longer provide contributions to employees' 529 accounts if the credit was not available, 28 percent indicated that they would continue to offer contributions, and 22 percent were not sure.

ARE THERE SIMILAR TAX EXPENDITURES IN OTHER STATES?

We identified six states (excluding Colorado) that have a tax expenditure for employers that contribute to an employee's qualified tuition plan. Of these states, four have a credit similar to Colorado's, while the remaining two offer a deduction. EXHIBIT 1.1 provides information regarding the tax expenditures in each of these states and Colorado.

EXHIBIT 1.1. TAX EXPENDITURES FOR EMPLOYER 529 CONTRIBUTIONS BY STATE

STATE	TYPE OF EXPENDITURE	VALUE OF EXPENDITURE	CAP
Colorado	Credit	20%	\$500 per employee per year
Illinois	Credit	25%	\$500 per employee per year
Nebraska	Credit	25%	\$2,000 per employee per year
Nevada	Credit	25%	\$500 per employee per year
Wisconsin	Credit	25%	\$800 per employee per year
Arkansas	Deduction	100%	\$500 per employee per year
Utah	Deduction	100%	\$1,960 total per year

SOURCE: Bloomberg BNA and Office of the State Auditor review of applicable state statutes.

ARE THERE OTHER TAX EXPENDITURES OR PROGRAMS WITH A SIMILAR PURPOSE AVAILABLE IN THE STATE?

The 529 Deduction for Individuals [Section 39-22-104(4)(i), C.R.S.] allows a state income tax deduction for individuals' contributions made to 529 accounts. This deduction can be claimed by individuals who contribute to their own 529 accounts and to individuals who contribute to another party's 529 account. Employees who make contributions to their 529 accounts in conjunction with employers who contribute under the 529 Credit, are eligible for the deduction.

Under the federal 529 exemption [Section 529(c)(1), Internal Revenue Code], distributions from qualified tuition plans are not taxable when used for qualifying education expenses. Since Colorado uses federal taxable income as the basis for calculating state income tax, this

effectively exempts qualifying distributions from Colorado state income tax as well.

WHAT DATA CONSTRAINTS IMPACTED OUR ABILITY TO EVALUATE THE TAX EXPENDITURE?

Because the 529 Credit was first available for Tax Year 2019 and taxpayers had not filed complete returns as of the time of our review, we were unable to assess the extent to which taxpayers claimed the credits for which they qualified.

WHAT POLICY CONSIDERATIONS DID THE EVALUATION IDENTIFY?

We did not identify any policy considerations related to this tax expenditure.