



Analysis of Original Bill

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Sponsor:

Bill Number: SB 1218

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Related Bills: See Legislative
History

Subject: Qualified Tuition Program Deduction/529 College Savings Plans

Summary

This bill would allow a deduction, under the Personal Income Tax Law, for amounts contributed by a qualified taxpayer to a qualified tuition program.

Recommendation – No position.

Reason for the Bill

The reason for the bill is to encourage savings for education.

Effective/Operative Date

As a tax levy, this bill would be effective upon enactment and specifically operative for taxable years beginning on or after January 1, 2018.

Program Background

Section 529 was added to the Internal Revenue Code by a 1996 piece of legislation authorizing “qualified tuition programs,” giving state programs both their popular name and tax-deferred status. Funds invested in these programs are not taxed federally when used for “qualified higher education expenses,” the definition of which has been expanded in 2015 to include computers and in 2017 to include up to \$10,000 in K-12 tuition.

California conforms, with modifications, to Section 529 Plans as of the “specified date” of January 1, 2015.

Federal/State Law

Existing federal and state laws allow individuals to deduct certain expenses, such as medical expenses, charitable contributions, interest, and taxes, as itemized deductions. For taxable years beginning after December 31, 2017, and before January 1, 2026, the federal Tax Cuts and Jobs Act (Act) repealed miscellaneous itemized deductions subject to the 2 percent floor,

and the overall itemized deduction limitation for high-income taxpayers.¹ Prior to the Act, certain other expenses for the production of income and certain employee business expenses are considered miscellaneous itemized deductions and the portion that exceeds 2 percent of adjusted gross income (AGI) may be deducted. Also, itemized deductions may be further limited for high-income taxpayers.

There is no deduction for contributions to a Section 529 Plan under current state or federal law.

This Bill

This bill would for taxable years beginning on or after January 1, 2018, allow a qualified taxpayer an income tax deduction equal to the lesser of the amount contributed during the taxable year to a qualified tuition program or the applicable amount, as specified.

The deduction would be allowed as an itemized deduction exclusive of the 2-percent of AGI floor that generally applies to miscellaneous itemized deductions.

“Qualified taxpayer” would mean an individual who, on behalf of a beneficiary, contributes money to a qualified tuition program and meets all of the other applicable requirements of Section 529 of the Internal Revenue Code.

The applicable amount would not exceed \$20,000, subject to indexing annually for inflation by the Franchise Tax Board for each taxable year beginning on or after January 1, 2019, as specified.

Implementation Considerations

The department has identified the following implementation concerns. Department staff is available to work with the author’s office to resolve these and other concerns that may be identified.

It is unclear whether the deduction would be limited on a per taxpayer, per plan, or per individual contributor basis. Additionally, it is unclear (1) whether amounts transferred or rolled over from another state’s Section 529 Plan would qualify for the deduction and (2) how the department could verify that a contribution was made to a qualified tuition program. The lack of guidance could cause disputes between taxpayers and the department and require the department to open up an audit in order to verify the amount of contributions made by taxpayers.

¹ An Act to Provide for Reconciliation Pursuant to Titles II and V of the Concurrent Resolution on the Budget for Fiscal Year 2018, Public Law 115-97, enacted December 22, 2107.

This bill would allow a qualified taxpayer to make a contribution to a Section 529 plan, and generate a deduction even if the funds are immediately withdrawn. If this is contrary to the author's intent, the author may wish to amend the bill to provide a recapture or disallowance provision.

Legislative History

AB 209 (Patterson, et al., 2015/2016), similar to this bill, would have allowed a deduction for contributions made to a qualified tuition program. AB 209 failed passage out of the Assembly by the constitutional deadline.

AB 675 (Gilmore, 2009/2010), substantially similar to this bill, would have allowed a deduction for contributions made to a qualified tuition program. AB 675 failed passage out of the Assembly by the constitutional deadline.

AB 819 (Runner, 2007/2008) and SB 643 (Florez, 2007/2008) were similar to this bill and would have allowed a deduction for contributions made by a qualified taxpayer to certain qualified tuition programs. AB 819 failed passage out of the Assembly by the constitutional deadline and SB 643 failed passage out of the Senate by the constitutional deadline.

Other States' Information

The states surveyed include *Illinois*, *Massachusetts*, *Michigan*, *Minnesota*, and *New York*. These states were selected due to their similarities to *California's* economy, business entity types, and tax laws.

Illinois conforms to IRC section 529, and has three qualified tuition programs: the College Illinois Prepaid Tuition Plan, the Bright Start College Savings Plan, and the Bright Directions College Savings Program. *Illinois* allows a deduction of up to \$10,000 per taxable year for single filers and up to \$20,000 per year for joint filers (per beneficiary) for contributions to its qualified tuition programs.

Massachusetts conforms to the federal treatment of qualified tuition programs under IRC section 529, and has its own qualified tuition program, the U Plan Prepaid Tuition Program. *Massachusetts* allows a deduction of up to \$1,000 in contributions to a Massachusetts Educational Financing Authority U Fund from their state income tax.

Michigan conforms to IRC section 529, and allows deductions of up to \$5,000 per taxable year for single filers and \$10,000 per taxable year for joint filers for contributions to its qualified tuition program, the Michigan Education Savings Program.

Minnesota conforms to IRC section 529, and has one qualified tuition program, the Minnesota College Savings Plan. *Minnesota* allows the option of claiming either a tax credit or deduction for contributions to any state 529 plan. Only one tax benefit can be claimed in a given tax year. Taxpayers may deduct up to \$3,000 for a married couple filing jointly or \$1,500 for all other filers for contributions made to a qualified 529 account or opt for a non-refundable tax credit of half of the contribution amount up to \$500, subject to phase-out.

New York conforms to the federal treatment of qualified tuition programs under IRC section 529, and has one qualified tuition program, the New York State College Choice Tuition Savings Program. *New York* allows a deduction of up to \$10,000 per taxable year for single filers and up to \$20,000 per year for joint filers for contributions to its qualified tuition program.

Fiscal Impact

The department's costs to implement this bill have yet to be determined. As the bill moves through the legislative process, costs will be identified.

Economic Impact

Revenue Estimate

This bill would result in the following revenue loss:

Estimated Revenue Impact of SB 1218 as Introduced on February 15, 2018
For Taxable Years Beginning On or After January 1, 2018
Assumed Enactment after June 30, 2018

(\$ in Millions)

Fiscal Year	Revenue
2018-2019	- \$150.0
2019-2020	- \$100.0
2020-2021	- \$100.0

This analysis does not account for changes in employment, personal income, or gross state product that could result from this bill or for the net final payment method of accrual.

Revenue Discussion

Based on Section 529 College Savings Plan data from the College Savings Plan Network, there were approximately 12.9 million Section 529 Plan accounts nationwide in 2016. It is estimated that approximately 10 percent, or 1.4 million, of these accounts are held by California taxpayers. The number of accounts is adjusted to reflect changes in the economy over time, resulting in an estimated total of 1.5 million accounts in 2018.

Based on TIAA-CREF Financial Services data, approximately 50 percent of account holders make regular annual contributions. This percentage rises to 58 percent in states with deductions or nonrefundable tax credits for contributions. This estimate assumes 60 percent, or 900,000, of the qualifying account holders would make regular contributions. It is further assumed that 60 percent, or 550,000, of the regular contributors would be able to claim the itemized deduction. Assuming an average contribution of \$2,200 per account results in an estimated \$1.3 billion in contribution deductions in taxable year 2018. This amount is then multiplied by an average tax rate of 7.4 percent, resulting in an estimated revenue loss of \$96 million in 2018.

The tax-year estimates are converted to fiscal-year estimates and then rounded to arrive at the amounts reflected in the above table.

Support/Opposition

Support: None provided.

Opposition: None provided.

Arguments

Proponents: Some may say that the bill would encourage family members and friends to contribute to a beneficiary's qualified tuition plan.

Opponents: Some may argue that this bill's itemized deduction would inadvertently exclude low- and middle-income taxpayers who are more likely to be reporting the standard deduction.

Policy Concerns

This bill would limit the proposed deduction to taxpayers who itemize deductions. A taxpayer who claims the standard deduction would be ineligible for this deduction.

This bill lacks a sunset date. Sunset dates generally are provided to allow periodic review of the effectiveness of a tax benefit by the Legislature.

This bill would create differences between federal and California tax law, thereby increasing the complexity of California tax return preparation.

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