



## **Analysis of Original Bill**

Author: Choi	Sponsor:	Bill Number: AB 350
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Attorney: Shane Hofeling	Related Bills: See Legislative History	

**Subject:** Qualified Tuition Program Deduction/529 College Savings Plan

### **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 reduce student debt and enhance financial planning.

### **Effective/Operative Date**

As a tax levy, this bill would be effective immediately upon enactment and specifically operative for taxable years beginning on or after January 1, 2019.

### **Federal/State Law**

Federal and state laws generally 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) suspended miscellaneous itemized deductions subject to the two percent floor, and the overall itemized deduction limitation for high-income taxpayers.<sup>1</sup>

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<sup>1</sup> 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, 2017.

Existing federal law, Internal Revenue Code (IRC) section 529, establishes a qualified tuition program where a person may purchase tuition credits or certificates on behalf of a designated beneficiary that entitle the beneficiary to the waiver or payment of qualified higher education expenses of the beneficiary (a "prepaid tuition program").

Contributions to a qualified tuition program must be made in cash. IRC section 529 does not impose a specific dollar limit on the amount of contributions, account balances, or prepaid tuition benefits relating to a qualified tuition account; however, the program is required to have adequate safeguards to prevent contributions in excess of amounts necessary to provide for the beneficiary's qualified higher education expenses.

### **State Law**

Current state law conforms to the federal provisions relating to qualified tuition programs under IRC section 529, as of the "specified date" of January 1, 2015,

Neither current state nor federal laws allow a tax deduction for contributions to a Section 529 Plan.

### **This Bill**

This bill would for taxable years beginning on or after January 1, 2019, 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 adjusted gross income 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 IRC.

The allowable deduction would be limited to:

- Six thousand dollars (\$6,000) for spouses filing joint returns, heads of households, and surviving spouses,
- Three thousand dollars (\$3,000) for a single individual or a spouse filing separately.

The deduction limitations would be subject to indexing annually for inflation by the Franchise Tax Board for each taxable year beginning on or after January 1, 2020, 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.

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

SB 1218 (Gaines, 2017/2018) substantially similar to this bill, would have allowed a deduction for contributions made to a qualified tuition program. SB 1218 failed passage out of the Senate by the constitutional deadline.

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.

## 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 two qualified tuition programs, the U Plan Prepaid Tuition Program and the U Fund Savings plan. Under the U Plan, any U.S. resident may purchase tuition certificates that can be redeemed at a designated maturity date. Each tuition certificate purchases a predetermined percentage of tuition and

mandatory fees at participating *Massachusetts* private and public colleges and universities. The interest earned on the U Plan investment and the benefits received from the certificates are exempt from *Massachusetts* income tax.

The U Fund Savings Plan is a *Massachusetts* college investment plan. Under this plan, all US residents are eligible to invest in a choice of portfolios tailored to a child's age. A deduction of up to \$1,000 (Single, head of household, married filing separate and \$2,000 (married filing joint) is allowed for contributions to a prepaid tuition and college savings plan from their state income tax.

*Michigan* conforms to IRC section 529, and offers two section 529 Plans, the *Michigan* Education Savings Program and the *Michigan* Education Trust. The *Michigan* Education Savings Program 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. Under the *Michigan* Education Trust, the beneficiary must be a *Michigan* resident at the time of purchase. A purchaser must reside in the United States but cannot be a resident of *Arizona, Illinois, New York, North Dakota, Ohio or Vermont* due to those states securities laws. Benefits used to pay college tuition and mandatory fees are exempt from *Michigan* income tax.

*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 subtraction from federal adjusted gross income of up to \$5,000 per taxable year for single filers and up to \$10,000 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 AB 350 as Introduced on February 4, 2019  
Assumed Enactment after June 30, 2019

(\$ in Millions)

<b>Fiscal Year</b>	<b>Revenue</b>
2019-2020	-\$130.0
2020-2021	-\$85.0
2021-2022	-\$90.0

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 13.3 million Section 529 Plan accounts nationwide in 2017. It is estimated that approximately 11 percent, or 1.4 million, of accounts are held by California taxpayers. The number of accounts is adjusted to reflect changes in the economy over time, resulting in an estimated 1.5 million total accounts in 2019.

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 65 percent, or 585,000, of the regular contributors would be able to claim the itemized deduction. Assuming an average annual contribution of \$2,200 per account results in an estimated \$1.3 billion in contribution deductions in taxable year 2019. This amount is then multiplied by an average tax rate of 6 percent, resulting in an estimated revenue loss of \$78 million in 2019.

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

## **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 additional differences between federal and California tax law, thereby increasing the complexity of California tax return preparation.

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