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LATE TESTIMONY

HOUSE COMMITTEE ON HIGHER EDUCATION

TESTIMONY REGARDING HB 2458
RELATING TO COLLEGE SAVINGS PROGRAMS

TESTIFIER: KURT KAWAFUCHI, DIRECTOR OF TAXATION (OR DESIGNEE)
DATE: JANUARY 31, 2008
TIME: 3:00PM
ROOM: 309

This bill proposes a deduction from gross income for contributions made to Hawaii's "TuitionEDGE" 529 College Savings Plan.

The Department of Taxation (Department) **strongly supports** this measure; **however prefers the approach taken in the Administration measure, HB 3078**.

I. HAWAII'S 529 PLAN, GENERALLY

Section 529 of the Internal Revenue Code allows states to sponsor programs that allow contributions to qualifying educational accounts that grow tax-free for purposes of financing certain qualifying education costs. Hawaii's 529 college savings plan is vested in Chapter 256, Hawaii Revised Statutes, and is overseen by the Department of Budget & Finance. With the high costs of post-secondary education, it is important that investment vehicles with tax benefits be provided for those saving for college.

II. DEDUCTIONS ARE IMPORTANT TO ENCOURAGE INVESTMENT

To ensure Hawaii taxpayers take advantage of Hawaii's TuitionEDGE 529 program, it is important that tax incentives are available to taxpayers. The benefits of tax incentives are twofold:

(1) Additional investment is attracted to Hawaii's plan, which commensurately lowers the cost of administering the fund for the fund participants; and
(2) Additional investment is encouraged from taxpayers so that additional revenue will be saved for the plan beneficiaries, which will help lower the financial burden of college tuition and other costs.

This bill, as well as the Administration measure, seeks to provide meaningful tax incentives

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for individuals to participate in Hawaii's TuitionEDGE 529 program.

III. OTHER JURISDICTIONS ALLOW INCENTIVES

Many other states offer similar tax incentives for contributions to their respective 529 college savings plans. Incentives include both deductions and a credit.

IV. TECHNICAL COMMENTS ON THIS MEASURE

THE DEPARTMENT PREFERS HB 3078—The Department prefers the approach taken in HB 3078 because it allows for a higher deduction. In order to truly ensure a tax advantage for Hawaii's TuitionEDGE 529 plan, the more generous deduction provided in the Administration's HB 3078 should be considered. And, the Administration's amount has already been factored into the Executive Budget.

RECAPTURE PROVISION—The Department suggests that a recapture provision be included in this measure, which would require any deducted amount of income to be included in income in a subsequent year if the plan is rolled-over into a non-Hawaii plan.

PROHIBITED DEPOSITS—The Committee may also want to consider adding recapture provisions that specify any "circular" use of account funds will be precluded from qualifying for the deduction. For example, if an account holder withdraws funds from the account and uses those funds to "re-deposit" funds, no deduction should be allowed for the "re-deposit."

IDENTIFICATION OF THE "FUND"—The Department prefers the characterization provided in HB 3078 of the deposits that qualify for this type of deduction. The Department would prefer that the deduction be allowed for contributions to the "program."

DEDUCTION FOR MARRIED COUPLES FILING SEPARATELY—The current wording of the deduction for married couples filing separately could be misinterpreted. In order to clarify the bill's intent, the Department suggests that paragraph (2) be eliminated. Paragraph (1) should cover all other taxpayers, including unmarried and married couples filing separately.

In sum, this bill provides targeted tax incentives to those trying to effectively save for the financial burdens of a college education. Hawaii should capitalize on these investment vehicles by providing incentives for its taxpayers to assure that every person can effectively save for education.

This bill will result in a revenue loss of approximately $2 million per year.

The Department strongly recommends the Committee pass this measure.

L E G I S L A T I V E

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SUBJECT: INCOME, Deduction for college savings program

BILL NUMBER: SB 3000; HB 3078 (Identical); SB 2087; SB 2251; SB 2660; HB 2458 Similar

INTRODUCED BY: SB 3000 by Hanabusa by request; HB 3078 by Say by request; SB 2087 by Espero, Sakamoto, Tokuda & 4 Democrats; SB 2251 by Kim, Chun Oakland, English, Gabbard, Sakamoto, Tokuda, Tsutsui, 6 Democrats & 1 Republican; SB 2660 by Sakamoto, Chun Oakland, Hooser, & Kim; HB 2458 by Caldwell & Lee

BRIEF SUMMARY: SB 3000/HB 3078 and HB 2458 amend HRS section 235-7 to provide that the annual deductions from gross income for contributions to the Hawaii college savings program shall be: (1) up to $10,000 for individual taxpayers; (2) up to $10,000 for married couples filing separately provided that each spouse may claim a deduction up to $10,000; and (3) up to $20,000 for married couples filing joint returns, individuals filing as head of households, or individuals filing as surviving spouses.

SB 2087 amends HRS section 235-7 to provide that the annual deductions from gross income for contributio to the Hawaii college savings program shall be: (1) up to $2,000 for individual taxpayers; (2) up to $2,000 fo married couples filing separately provided that each spouse may claim a deduction up to $2,000; and (3) up t $4,000 for married couples filing joint returns, individuals filing as head of households, or individuals filing surviving spouses. Further stipulates that the adjusted gross income of a taxpayer who qualifies for a deducti under this section shall not exceed $100,000 or $200,000 in the case of a married couple. The amendments made to this section shall not be repealed when this section is reenacted on January 1, 2013 pursuant to sectic 3 of Act 166, SLH 2007.
Deductions in excess of a taxpayer's liability shall be applied to subsequent tax liability until exhausted.

SB 2251 adds a new section to HRS section 235 to allow taxpayers to take a tax deduction for contributions made to a college savings account under HRS chapter 256 provided that the deduction shall not exceed $5,000 for taxpayers filing individually and $10,000 for taxpayers filing jointly. Requires the director of taxa to prepare the necessary form to claim the deduction, may require proof of the claim for the tax deduction, an may adopt rules pursuant to HRS chapter 91.

SB 2660 amends HRS section 235-7 to provide that the annual deductions from gross income for contributions to a qualified tuition program established pursuant to IRC section 529 shall be: (1) up to $5,00(for individual taxpayers; (2) up to $5,000 for married couples filing separately provided that each spouse ma claim a deduction up to $5,000; and (3) up to $10,000 for married couples filing joint returns, individuals fili as head of households, or individuals filing as surviving spouses.

EFFECTIVE DATE: Tax years beginning after December 31, 2007

STAFF COMMENTS: SB 3000 and HB 3078 are administration measures submitted by the department of budget and finance BUF-02(08). The legislature by Act 81, SLH 1999, established a college savers

program on the state level to allow taxpayers to save for a child's college education by participating in a state college savings program. This plan is patterned on the rules governing such plans established under Section 529 of the federal Internal Revenue Code. Under that section, contributions made to such qualified programs receive no special tax treatment but the law specifies that when the distribution is made from the account for beneficiary, the amount in excess of the contribution is taxable as part of the beneficiary's income. There is ı benefit or incentive for the contributor, in other words the contribution is made with after tax dollars.

These measures propose an income tax deduction from \$2,000/\$4,000 to \$10,000/\$20,000 annually to encourage taxpayers to participate in the college savers program. In the administration's justification sheet, i estimated that the potential revenue loss for this proposal is \$2.8 million; however, if the measure is successf encouraging more participation in the program, then the revenue loss would be significant.

It should be remembered that it has long been the intent of the state legislature to maintain conformity betwe Hawaii's income tax law and the federal Code to insure that administration and compliance costs will be minimized. Given that there is no similar provision on the federal level, this proposal would create yet anoth difference in the definition of income for state income tax purposes.

If it is the intent of the legislature and administration to encourage families to set money aside for their childr higher education, the deduction, as proposed, is regressive in that it favors those at the high end of the incom scale who probably would have the discretionary income to set aside funds and punishes those at the bottom end of the income scale as those families are less likely to put the maximum aside to qualify for the deductio Inasmuch as the proposed deduction is a back door expenditure of tax dollars, it would be far more efficient f lawmakers to set up a subsidy program that would provide a sliding scale of percentages to subsidize or "match" contributions made to a qualified college savings account where the percentage of match would be inversely graduated. Thus, those lower income families with less discretionary income would see their small contributions matched at a higher percentage while those higher income families would see the match phase- after a certain level of contribution is made. This would take the onus of administering the program out of th tax department and places it within the financial institutions who would benefit from the use of the money. T would also insure that the contributions are made to a local institution that would participate in the state matching program. This would be far more efficient and accountable that utilizing the tax system to encoura parents to save for their children's college education.

Digested 1/28/08