TESTIMONY BY GEORGINA K. KAWAMURA
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STATE OF HAWAII
TO THE HOUSE COMMITTEE ON HIGHER EDUCATION
ON
SENATE BILL NO. 2660, S.D. 3

March 11, 2008

RELATING TO COLLEGE SAVINGS PROGRAMS.

Senate Bill No. 2660, S.D. 3, proposes to provide a state income tax deduction for contributions to <u>any</u> qualified tuition program established pursuant to Section 529 of the Internal Revenue Code. The Bill proposes a tax deduction of up to $5,000 for taxpayers filing individually and up to $10,000 for married couples filing joint returns, heads of households, or surviving spouses. In addition, S.D.3 proposes establishing a $75,000 cap on the total tax deduction that may be claimed per college savings account.

The Department of Budget and Finance supports the intent of this bill, which is consistent with the Administration's Bill that provides individuals an incentive in the form of a State tax deduction for contributions to the State of Hawaii's 529 College Savings Program called "HI 529."

However, we strongly oppose allowing the State tax deduction for contributions to <u>any</u> qualified 529 plan. Rather than encourage Hawaii residents to invest in other states' plans, we would like to see Hawaii's plan grow, because with the growth of Hawaii's plan, there is opportunity for our plan participants to benefit from lower program fees. Hawaii's HI 529 College Savings Program is a "direct sold" plan as opposed to an "advisor sold" plan. Typically lower costs are associated with direct-sold plans; as advisor-sold plans generally assess an advisor fee or commission to the plan owner. Testimony submitted to the Senate Committee on Economic Development and Taxation's hearing on the bill on February 12, 2008, inferred that restricting the state tax deduction benefit to the State's 529 plan would not allow Hawaii families the benefit of being able to invest in "any" of the other state's 529 programs. On the contrary, this would not preclude any Hawaii resident from investing in any 529 plan that their financial advisor recommends. They could still open an account in any state's 529 plan that their financial advisor recommends. However, the advantage of the state tax deduction would only be available to residents who invest in a Hawaii 529 plan account. Testimony was also submitted at this same hearing that cited one source which ranked Hawaii's 529 plan at 39th in the nation. This citation was very misleading as the ranking cited was done prior to the recent revamping of Hawaii's 529 Program and contracting of a new third party administrator, Upromise Investments Inc. and investment manager, The Vanguard Group, Inc.

Of equal importance are the following additional reasons that the state tax incentive should remain with Hawaii's plan only:

1. Accountability. It would be difficult to effectively monitor and administer a program that provides a State tax benefit for contributions made to other state's 529 programs. There would be no effective policy measurement as the other state's program managers would not be able to provide necessary data to Hawaii. In contrast, the program manager for Hawaii's plan is contractually required to provide data and statistics on the program as well as geographical and socio-economic data. This data could then be used to ensure that the program is reaching a broad-base of families from a wide-range of income levels.

2. Responsible tax policy. Keeping the deduction to the "in-state" plan would provide for a more controlled tax impact. If the state tax deduction benefit were opened up to any 529 program, there would be no means on which to base a projection of the tax impact. Also, Hawaii's program manager is contractually required to provide data necessary for the State's Tax Department to monitor whether the tax benefits are being abused. While Standing Committee Report No 2533 stated that the Committee on Economic Development and Taxation received a fiscal impact statement from the Department of Taxation estimating the revenue impact of Senate Bill No. 2660, S.D.1, at $1,000,000 annually, the estimate was based on the number of current participants in the Hawaii program only. The estimate did not include or address the potential revenue loss for all Hawaii residents investing in "any" 529 Program.

Senate Bill No. 2660 also proposes a maximum tax deduction of $5,000 for taxpayers filing individually, and $10,000 for taxpayers filing jointly. We recommend the higher maximum deductions as provided for in Senate Bill No. 3000 of $10,000 for taxpayers filing individually, and $20,000 for taxpayers filing jointly. We believe that the higher maximum deductions will be a greater incentive and better assist individuals and families saving for our children's future college expenses.

In response to the proposed $75,000 cap on the total tax deduction that may be claimed per account, we believe that such a limitation would be a disincentive to continue contributions or participation in the HI 529 Program once an account owner reaches the cap. The incentive provided should realistically enable account owners to pay for future tuition expenses. In the August 2007 issue of Money Magazine, the estimated cost for four years of tuition, room and board at a public college is estimated to be $125,000 by 2022; and closer to $300,000 for a private college.

We have recently been made aware that other states with similar tax incentives have tightened-up their program to prevent possible abuse. The Department of Budget and Finance is working with the Department of Taxation to address these issues which may require additional statutory changes. The items to be addressed are:

1. Prevent account owners from depositing funds in one year, withdrawing the funds in the subsequent year, and then re-depositing the same funds and claim a deduction for both years.
2. Prevent account owners from depositing funds into a HI 529 account, taking the deduction, and subsequently transferring the funds out to another state's 529 program.

We are also pursuing an additional statutory change to allow anyone to contribute into a HI 529 account. Currently, only the account owner is allowed to contribute into a HI 529 account, preventing for example, grandparents from contributing directly into a grandchild's account. We would like to change this restriction and will work with this Committee or subsequent committees on providing the necessary statutory language changes as this bill progresses through the legislative process.

Therefore, while we support the intent of Senate Bill No. 2660, S.D. 3, we recommend the language that provides for a state tax deduction benefit for contributions made to Hawaii's 529 program <u>only</u>, and no cap on the total deduction.

Thank you for this opportunity to provide testimony on this measure.