

TESTIMONY BY GEORGINA K. KAWAMURA
DIRECTOR, DEPARTMENT OF BUDGET AND FINANCE
STATE OF HAWAII
TO THE SENATE COMMITTEE ON EDUCATION
ON
SENATE BILL NO. 3000

January 28, 2008

RELATING TO THE STATE OF HAWAII SECTION 529 COLLEGE SAVINGS
PROGRAM.

Senate Bill No. 3000 proposes a state tax incentive for participants to contribute to their Hawaii 529 College Savings Program, called "HI 529." Established in 2002 and originally named "TuitionEDGE," the administration of the Program was changed in November 2007 and re-branded as "HI 529 Hawaii's College Savings Program." As of December 31, 2007, the program had approximately 3,400 accounts and \$41.7 million in program assets. The goal of the proposed tax deduction for contributions is to increase participation in the program, helping Hawaii families set aside funds for future higher education costs.

The Department of Budget and Finance strongly supports this administration bill.

The HI 529 college savings program is authorized by Section 529 of the Internal Revenue Code and allows each state to establish and design, within program requirements, their own college savings program. The primary benefit of the 529 programs is that earnings on the contributions grow federal tax-deferred, and withdrawals used to pay for a beneficiary's qualified higher education costs are federal tax-free. This tax-exempt treatment was made permanent by the federal Pension Protection Act of 2006. Hawaii also exempts the investment earnings from Hawaii state income taxes, provided that the earnings are used for qualified educational expenses.

WITNESS MY HAND AND SEAL
THIS 28th DAY OF JANUARY 2008

All 50 states currently have at least one state-sponsored 529 plan, and over 80% of the states provide some kind of additional in-state tax incentive, such as the proposal contained in this bill, to encourage their residents to participate and contribute to their in-state program. These 529 programs provide an easy way to save for college by opening an account and making a minimum contribution (Hawaii's plan's minimum is a low \$15). Plan participants select from an array of investment options and their account is professionally managed by an outside investment company hired by the State as third party program administrator.

Currently, aside from the state tax exemption on earnings, there is no additional incentive for Hawaii residents to invest in the State's HI 529 Program. The treatment of investment earnings as State tax-exempt, are the same whether they invest in Hawaii's 529 college savings program or any other state's 529 program. Senate Bill No. 3000 proposes a state income tax deduction for contributions made to an account in the State of Hawaii's 529 college savings program, of up to \$10,000 for individual taxpayers and married couples filing separate returns; and up to \$20,000 for married couples filing joint returns, with excess deductions carried over to subsequent tax years. Both the former and current college savings program managers have suggested that the state establish this tax incentive as a means to increase program participation. This bill should provide a significant incentive for Hawaii residents to establish accounts with Hawaii's program, HI529, and start saving for their children's futures.

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.

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The items to be addressed are:

1. Prevent account owners from depositing funds in December, withdrawing the funds in January, and 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. We will work with this Committee or subsequent committees on providing the necessary statutory language changes as this bill progresses through the legislative process.

Higher education costs will only continue to rise, and trying to save for higher education can be a difficult task for Hawaii families juggling various daily living expenses. This bill will give additional incentive for parents to put aside periodic college savings in an easy way. Thank you for this opportunity to provide testimony in strong support of this administration measure.