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To: The Honorable Donovan M. Dela Cruz, Chair;
The Honorable Gilbert S.C. Keith-Agaran, Vice Chair;
and Members of the Senate Committee on Ways and Means

From: Rona M. Suzuki, Director
Department of Taxation

Re: **H.B. 1469, H.D. 2, S.D. 1, Relating to the College Savings Program**
Date: Wednesday, January 29, 2020
Time: 10:00 A.M.
Place: Conference Room 211, State Capitol

The Department of Taxation (Department) supports the intent of H.B. 1469, H.D. 2, S.D. 1. This measure creates a deduction from income tax for contributions made to an account in the Hawaii College Savings Program within specific limits and circumstances.

The Department notes that it can be prepared to administer this measure for taxable years beginning after December 31, 2019, as currently written, provided that a non-defective effective date is inserted.

Thank you for the opportunity to provide comments.

DAVID Y. IGE
GOVERNOR

CRAIG K. HIRAI
DIRECTOR

ROBERT YU
DEPUTY DIRECTOR

STATE OF HAWAI'I
DEPARTMENT OF BUDGET AND FINANCE
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EMPLOYEES' RETIREMENT SYSTEM
HAWAI'I EMPLOYER-UNION HEALTH BENEFITS TRUST FUND
OFFICE OF THE PUBLIC DEFENDER

ADMINISTRATIVE AND RESEARCH OFFICE
BUDGET, PROGRAM PLANNING AND MANAGEMENT DIVISION
FINANCIAL ADMINISTRATION DIVISION
OFFICE OF FEDERAL AWARDS MANAGEMENT (OFAM)

WRITTEN ONLY

TESTIMONY BY CRAIG K. HIRAI
DIRECTOR, DEPARTMENT OF BUDGET AND FINANCE
TO THE SENATE COMMITTEE ON WAYS AND MEANS
ON
HOUSE BILL NO. 1469, H.D. 2, S.D. 1

January 29, 2020
10:00 A.M.
Conference Room 211

RELATING TO THE COLLEGE SAVINGS PROGRAM

The Department provides comments on H.B. 1469, H.D. 2, S.D. 1.

House Bill No. 1469, H.D. 2, S.D. 1 proposes to provide for an annual state income tax deduction of $4,000 per individual and $8,000 for a married couple filing jointly, heads of household, or surviving spouses, for eligible contributions made into an account owned by the taxpayer in Hawaii's 529 College Savings Program established pursuant to HRS chapter 256 and Internal Revenue Code section 529. The Bill also proposes for eligible excess deductions to be carried forward into subsequent tax years and be subject to recapture and penalties if the taxpayer makes a subsequent nonqualified withdrawal.

The Department supports the intent of the bill to encourage and incentivize individuals and families to save funds for the increasing costs of higher education, but notes there may be a general fund tax impact depending on the amount of the deduction allowed. An income limit for eligible deductions could be considered.

Thank you for the opportunity to provide our testimony on this bill.

TAX FOUNDATION OF HAWAII

126 Queen Street, Suite 304 Honolulu, Hawaii 96813 Tel. 536-4587

SUBJECT: INCOME, College Savings Program Deduction

BILL NUMBER: HB 1469, SD-1

INTRODUCED BY: Senate Committee on Higher Education

EXECUTIVE SUMMARY: Proposes a deduction for contributions to a college savings program account. Other states offer similar incentives.

SYNOPSIS: Adds a new section to chapter 235, HRS, to allow a deduction for a contribution to an account established in the Hawaii college savings program under chapter 256, HRS.

The amount deductible is not to exceed $4,000 ($8,000 for married taxpayers filing a joint return, heads of household, or surviving spouses). Only amounts contributed within the taxable year count; if a contribution is mailed in, it counts if it is postmarked within the taxable year.

The deduction is "above the line," meaning that it is deducted when computing the taxpayer's Hawaii adjusted gross income, unlike most itemized deductions.

The deduction is not allowed for a contribution that is rolled over from another state's college savings program.

If the amount of the deduction exceeds the taxpayer's taxable income, the excess may be used as a deduction in subsequent taxable years until exhausted.

Provides for recapture of the deduction if the taxpayer makes a nonqualified withdrawal from the program.

Makes conforming amendments.

EFFECTIVE DATE: 7/1/2050; applicable to taxable years beginning after 12/31/2019.

STAFF COMMENTS: The Hawaii college savings program under chapter 256, HRS, is a college savings program intended to qualify under section 529, IRC.

Under the IRC, contributions to a 529 plan are not deductible, but the monies in the plan can earn income tax-free and will not be taxed when the money is taken out to pay for college.

Hawaii income tax law conforms to IRC section 529, with minor modifications such as a withdrawal is nonqualified for Hawaii purposes if it is used to purchase software. See section 235-2.4(hh), HRS, which decouples from IRC section 529(e)(3)(A)(iii).

According to savingforcollege.com, over 30 states currently offer a full or partial tax deduction or credit for 529 plan contributions. Hawaii does not.

Digested 1/26/2020

sifma
Invested in America

January 27, 2020

The Honorable Donovan M. Dela Cruz, Chair
The Honorable Gilbert S.C. Keith-Agaran, Vice Chair
Senate Committee on Ways and Means
Hawaii State Capitol
415 South Beretania St.
Honolulu, HI 96813

RE: HB 1469 HD2 SD1, Establishes a state income tax deduction for eligible contributions made to the Hawaii college savings program, OPPOSE UNLESS AMENDED

Dear Chair Dela Cruz, Vice Chair Keith-Agaran and Senate Ways and Means Committee Members:

The Securities Industry and Financial Markets Association[1] is a national trade association which brings together the shared interests of more than 340 broker-dealers, investment banks and asset managers, many of whom have a substantial presence in Hawaii.

We regretfully are writing to oppose HB 1469 HD2 SD1 (hereinafter "HB 1469") unless amended. This legislation would enable qualifying contributions to the Hawaii college savings program to be deducted from gross income for state tax purposes. While SIFMA supports tax incentives generally, we believe that any deduction should apply to contributions to <u>all</u> qualified 529 plans and not just to the state-sponsored plan. We encourage you to consider the following points:

- **<u>A College Education Benefits Hawaii</u>.** The benefits of a college education are well-documented. A 2014 Pew Research Center report found that high school graduates earned roughly 62% of the salary of college graduates and that "on virtually every measure of economic well-being and career attainment . . . young college graduates are outperforming their peers with less education."[2] A 2019 College Board report concluded, among other things, that college graduates are healthier, have substantially higher median incomes, pay more taxes, have lower unemployment rates, and are less likely to receive public assistance.[3]

- **<u>College Tuition Costs are Increasing Faster than Inflation</u>.** College costs have outpaced inflation nearly every year since the early 1980s[4] – sometimes reaching as high as 9.5% above the

[1] SIFMA is the leading trade association for broker-dealers, investment banks and asset managers operating in the U.S. and global capital markets. On behalf of our industry's nearly 1 million employees, we advocate for legislation, regulation and business policy, affecting retail and institutional investors, equity and fixed income markets and related products and services. We serve as an industry coordinating body to promote fair and orderly markets, informed regulatory compliance, and efficient market operations and resiliency. We also provide a forum for industry policy and professional development. For more information, visit www.sifma.org.
[2] Pew Research Center, "The Rising Cost of Not Going to College." Feb. 2014.
[3] College Board, "Education Pays 2019."
[4] Bloomberg Business, "College Tuition in the U.S. Again Rises Faster Than Inflation." Nov. 2014.

rate of inflation. In the last 5 years, tuition and fees have risen by about 6% for a public four-year program and 9% at private non-profit four-year programs, adjusted for inflation.[5]

- **529 College Savings Plans are One of the Best Ways to Pay for College.** Many entities, including Kiplinger's and savingforcollege.com, believe that 529 plans are the best college savings vehicle. These plans are appealing because they encourage ongoing savings, earnings on these plans are free from federal and Hawaii state taxes, and in some states, contributions are deductible for state income tax purposes so long as they are used for "qualified higher education expenses." According to research by T. Rowe Price, $23,000 in 529 savings over 18 years would cover $51,000 in college and loan costs. Put another way, when faced with $40,000 in college costs, Hawaii residents can either save $105 per month for 18 years before college or pay $424 per month for 10 years after college.[6]

  In December 2019, the SECURE Act became law.[7] This new law expands the types of expenses for which funds in a 529 college savings account can be used to include certain apprenticeship programs and student loan repayments. Given the different time-horizons between saving for college and paying off loans, encouraging savers to enroll in the 529 plan that best fits their needs is more important than ever.

- **An Upfront State Tax Deduction for All Qualified 529 Plans Will Further Incentivize Hawaii Residents to Save.** An upfront state tax deduction for 529 contributions will encourage Hawaii residents to save early and often for future college expenses. It is important, however, that the deduction apply to all qualified 529 plans and not just the state plan.

  There are a lot of factors to consider when choosing the right 529 plan. This includes the investor's risk tolerance, the fees charged, the plan's past performance, the ability to work with a trusted adviser, and any number of other considerations. A tax deduction for just the state-sponsored plan effectively limits investor choice by making the driving factor where the deduction is available rather than which 529 plan best suits the college saver's overall needs.

  A state tax deduction for contributions to all qualified 529 plans provides additional benefits. Among other things, it:

  - Allows savers to work with financial advisors to save through a 529 plan;
  - Ensures that all Hawaii savers receive the same tax treatment;
  - Encourages new Hawaii residents to continue contributing to their existing 529 plans; and
  - Allows savers to work with a single financial institution on their lifetime savings goals.

- **Financial Advice Benefits Both Savers and Business.** The Hawaii college savings plan is only sold directly through the state of Hawaii. Unlike many other states, Hawaii does not currently offer an advisor-sold plan. HB 1469's state tax deduction for just the state-sponsored plan precludes savers who work with a trusted financial advisor to identify, contribute and manage their college savings plan from getting the same tax benefits as those who do not seek professional advice. This is counter to the bill's goal of encouraging college saving, particularly

[5] College Board, "Tuition and Fees and Room and Board Over Time, 1988-89 to 2018-19, Selected Years." *See* Figures 9 and 10.
[6] T. Rowe Price Investor Magazine, Fall 2016 Edition.
[7] 116 P.L. 94, 2019 Enacted H.R. 1865, 133 Stat. 2534.

since 86% of families with college-bound children that work with an advisor have saved for college, compared to only 59% of families without an advisor. 529 plan use also increases when a family has an advisor, from 39% to 57% percent.[8]

Similarly, a deduction for all qualified 529 plans ensures that small, medium and large securities firms based in Hawaii can continue to offer a full range of services to Hawaii residents.

- **Tax Deductions for Contributions to All Qualified 529 Plans Have Been Successful in Other States.** Arizona, Arkansas, Kansas, Minnesota, Missouri, Montana and Pennsylvania[9] all currently provide a state tax deduction for contributions to all qualified 529 plans. Arizona implemented its deduction and found it so successful that the state subsequently more than doubled the deduction's limit to further spur education-related savings. Minnesota – the most recent state to adopt a tax deduction of any type for 529 college savings plans – chose to apply that deduction to all qualified plans in 2017.

For the reasons laid out above, SIFMA encourages you to amend the legislation to provide the deduction for contributions to all qualified 529 plans. We appreciate your willingness to receive our comments. If you have any questions, please contact me at kchamberlain@sifma.org or 202-962-7411.

Sincerely,

Kim Chamberlain

Kim Chamberlain
Managing Director & Associate General Counsel
SIFMA

[8] Fidelity Investments 2018 College Savings Indicator Study.

[9] Ohio also has tax parity legislation that has bi-partisan sponsors in both houses and is likely to be enacted in 2020.

Savingforcollege.com

January 28, 2020

The Honorable Donovan M. Dela Cruz, Chair
The Honorable Gilbert S.C. Keith-Agaran, Vice Chair
Senate Committee on Ways and Means
Hawaii State Capitol
415 South Beretania St.
Honolulu, HI 96813

RE: HB 1469 HD2 SD1, Relating to the Hawaii college savings program, Proposed Amendments

Dear Chair Dela Cruz, Vice Chair Keith-Agaran and Senate Ways and Means Committee Members:

I am writing to address some issues and concerns raised by the current draft of HB1469 and to offer some suggestions to maximize the benefits of this bill's initiative.

I have been affiliated with Savingforcollege.com for over 20 years following an active law practice in New York City dealing with state tax law (I remain licensed in NYS). Savingforcollege.com has been described as the leading independent resource and authority on 529 plans nationally. As such, I offer an unique perspective and experience on many different matters on IRC 529 college savings plans.

The intent of my proposed changes to the current draft of this bill is to result in greater participation by Hawaiian families and greater benefits from what IRC Section 529 qualified college savings plans, including the plan offered by the Department of Budget and Finance (the DBF Plan), and other qualified plans of such families' choice, can offer at the federal and state tax levels. Allowing choice, similar to how families choose how to save for retirement (Hawaii families do not have 1 option to save for retirement), including allowing plans eligible for guidance by a licensed financial advisor to offer the same State tax benefits as the DBF Plan is vital.

My recommendations are also to ensure that these benefits are not abused by avoiding unintended tax savings opportunities. Through requiring participation in a college savings account for more than 1 year to enjoy the deduction and thereby discouraging "run-through" same week/month deductible contributions and tax-free withdrawals, HI would then join states such as Michigan, Minnesota and Wisconsin in avoiding the outcome most states encounter with their state tax deduction.

I have provided a list of bullet points to these suggestions (attached) and am happy to offer up specific statutory language as well.

I applaud the Legislature for moving forward on this bill and hope that the Committee consider these suggestions to better ensure the success of this significant legislation that will benefit so many Hawaiian families.

Thank you very much for your consideration.

If you wish to contact me please reach me through the information below my signature.

Sincerely,

/s/ Christopher A. Stack, Esq.

Managing Consultant
Savingforcollege.com

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O. (203) 656-6627

Proposed Amendments/Enhancements Explanation

The following 5 proposed modifications to pending HB1469 serve to further enhance to goal of the legislation to encourage Hawaii families to save and invest for future college expenses and take advantage of the benefits of 529 plans under federal and state law.

1. **<u>Section 235-1 definition addition.</u>**

- Adds "Qualified Higher Education Expenses" as a defined term.
- Updates HI law to include changes to the IRC signed into law late December 2019.
- Allows 529 plans to be used to pay for trade apprenticeship training expenses and to pay up to $10,000 of qualified student loans.
- *See Section 2 of the modified bill.*

2. **<u>Deduction for contributions to qualified college savings plans.</u>**

- Most states with an income tax offer some type of tax deduction to motivate saving for college.
- Some states limit deduction for contributions to their own plan and other states allow families to choose.
- SD-1 currently provides for deduction for contributions to the Hawaii-sponsored plan only.
- This change offers the deduction for contributions to any 529 qualified college savings plan that Hawaii families may choose, *including* the Hawaii plan overseen by the Director of Finance.
- Most 529 accounts opened by Hawaiian families to date have been in other plans, not the Hawaii plan.
- Many seek the help of a licensed financial advisor who cannot help them with the Hawaii plan. (HI once offered an advisor-guided 529 plan but closed the plan down years ago).
- Other Hawaii families select a different plan due to different investment choices, lower fees or other features, similar to how everyone chooses their own retirement or other investment accounts.
- *See Section 3 of modified bill.*

3. Discourages pass-through of college payment deduction

- The purpose of the deduction is to encourage families to save and invest for future college expenses.
- Often, in other states, one contributes for the deduction and withdraws to pay tuition within a few days.
- This eliminates same year contribution and deduction common with other state plans.
- The deduction is reduced by the amount withdrawn in the same taxable year.
- If one contributes $8,000 and withdraws $7,000 the same year, only a $1,000 deduction is allowed.
- This reinforces the purpose of long-term tax-deferred college investing.
- *See Section 3 of modified bill.*

4. 4 Year Carry-forward of deductions in Excess of Annual Deductible Limit.

- HB1469 allows an annual deduction of $4,000 for a single filer and $8,000 for a joint filer.
- If one were to invest more during the same tax year there's no deductible benefit on the excess.
- This limit encourages savers to hold back and limit saving for college to the annual deductible amount.
- This change keeps the annual cap on the deduction but encourages families to save more when possible.
- Any excess amount contributed can be carried forward and deducted in the future, up to 4 years.
- 11 other states offer this feature but nearly all with a longer time-frame to carry-forward.
- *See Section 3 d. of modified bill.*

5. Recapture of the Deduction Consistent with Federal Tax Law for Non-Qualified Withdrawals.

- HB1469 currently provides for a recapture of the deduction taken for a non-qualified withdrawal.
- This language makes clear that such treatment applies to such withdrawals from all 529 college savings plans.
- The revised language also reflects current federal tax law for the application of the penalty as well.