

Department of Legislative Services  
 Maryland General Assembly  
 2016 Session

FISCAL AND POLICY NOTE  
 Third Reader

House Bill 335  
 Ways and Means

(Delegate Lierman)

Budget and Taxation

**Income Tax Subtraction Modification - College Savings Plans - Contributions**

This bill expands eligibility of the college savings plan income tax subtraction modification by allowing each person who contributes funds to a qualified plan to claim the subtraction modification. Under current law, only the account holder who contributes funds can claim the subtraction modification.

The bill takes effect July 1, 2016, and applies to tax year 2016 and beyond.

**Fiscal Summary**

**State Effect:** General fund revenues decrease by \$455,300 in FY 2017 as a result of additional subtraction modifications claimed against the personal income tax. Future year estimates reflect a 3% annual increase in eligible contributions. Expenditures are not affected.

(in dollars)	FY 2017	FY 2018	FY 2019	FY 2020	FY 2021
GF Revenue	(\$455,300)	(\$469,000)	(\$483,100)	(\$497,600)	(\$517,700)
Expenditure	0	0	0	0	0
Net Effect	(\$455,300)	(\$469,000)	(\$483,100)	(\$497,600)	(\$517,700)

*Note:() = decrease; GF = general funds; FF = federal funds; SF = special funds; - = indeterminate effect*

**Local Effect:** Local revenues decrease by \$287,600 in FY 2017 and by \$327,000 in FY 2021. Local expenditures are not affected.

**Small Business Effect:** None.

## Analysis

**Current Law:** The College Savings Plans of Maryland Board currently operates two qualified tuition plans: the Maryland Prepaid College Trust and the Maryland College Investment Plan. At the end of fiscal 2015, the plans had a total of 188,900 accounts with assets totaling \$5.2 billion, with the Maryland College Investment Plan comprising about 80% of all accounts and assets. Chapter 548 of 2008 authorized the board to establish a third plan, the Maryland Broker-Dealer College Investment Plan, but the board has yet to do so.

An account holder can claim a subtraction modification for the amount of advanced payments made during the tax year under a prepaid contract with the Maryland Prepaid College Trust. The maximum value of the subtraction modification is limited to \$2,500 for each prepaid contract. Any unused amount of the subtraction modification can be carried forward to future tax years until the full amount of the excess is used.

An account holder can also claim a subtraction modification for the amount contributed to a Maryland College Investment Plan. For each account holder for all investment accounts maintained in the Plan for a qualified beneficiary, the subtraction modification may not exceed \$2,500 per qualified beneficiary. This limitation is increased to \$5,000 for married individuals who file jointly. Any unused amount of the subtraction modification may be carried forward for up to 10 tax years.

### **Background:**

#### *Federal Tax Benefits and 529 Plans*

Qualified tuition plans, also known as 529 plans, are state programs that allow an individual to either prepay or contribute to an account established for paying a student's qualified education expenses at an eligible educational institution. Forty-nine states and the District of Columbia have at least one type of 529 plan. In addition, a group of private colleges and universities offer a prepaid tuition plan. There are no income restrictions on who can set up or contribute to an account.

The U.S. Congress enacted legislation in 1996 and 2001 establishing federal tax advantages for qualified accounts. Contributions are not deductible for federal tax purposes; however, amounts deposited in the account grow tax free and distributions are not subject to federal or state taxes if the distributions are used for qualified education expenses. These tax advantages are very similar to the federal tax treatment of Roth IRAs.

Even though 529 plans are gaining in popularity, about 7% of families in the United States who said they expect major education expenses within the next 5 to 10 years had a 529 plan

or Coverdell savings account, a similar but less used education savings account. The families that have either a 529 plan or Coverdell savings account reported median financial assets of \$413,500 and median incomes of \$142,400. Nationwide, parents comprise about 86% of the contributors to 529 plans, grandparents about 10%, and other family and unrelated individuals the remaining 4%.

### *529 Tax Benefits – Maryland and Surrounding States*

According to the National Conference of State Legislatures, most states that imposed an income tax in calendar 2014 provided a State tax benefit for 529 contributions. Twenty-seven states had a deduction with a limit on the maximum amount that can be deducted, four states had a deduction for the full amount of the eligible contribution in the year, and three states had an income tax credit. Only eight states, including Pennsylvania, allowed the tax benefit for contributions made to other state plans.

Of the surrounding states, West Virginia allows the full amount of contributions to be deducted and Pennsylvania, Virginia, and the District of Columbia allow a deduction for contributions up to a specified maximum amount. Delaware does not provide a state tax benefit.

In addition to tax benefits, in calendar 2014, 12 states matched contributions made to a 529 plan. Most of the states limit eligibility to lower-income families as well as limiting the amount of the match in a year and/or throughout the life of the account. Of the surrounding states, West Virginia provides a 100% match up to \$500 annually with a lifetime maximum of \$2,500. Applicants must meet family income guidelines based on the number of dependents, and the beneficiary must be age 12 or younger.

**Exhibit 1** shows the number of resident tax returns that claimed the subtraction modification in tax year 2014 by federal adjusted gross income, the percentage of all returns that claimed the subtraction modification, and the average deduction claimed.

**Exhibit 1**  
**College Savings Plans Subtraction Modification**  
**Tax Year 2014**

<u>FAGI</u>	<u>Total Tax Returns</u>	<u>Number</u>	<u>% of All Returns</u>	<u>Average Claim</u>
Less than \$25,000	1,032,398	598	0.1%	\$2,893
\$25,001-\$100,000	1,400,308	8,376	0.6%	2,780
\$100,001-\$200,000	500,515	26,124	5.2%	3,743
\$200,001-\$500,000	157,246	20,064	12.8%	5,636
Over \$500,000	34,077	4,277	12.6%	8,053
<b>Total</b>	<b>3,124,544</b>	<b>59,439</b>	<b>1.9%</b>	<b>\$4,499</b>

FAGI: federal adjusted gross income

Note: Tax returns (total and those claiming the subtraction modification) reflect resident tax returns only.

Source: Comptroller's Office; Department of Legislative Services

In calendar 2015, Maryland residents established a total of 28,442 College Investment Plans and 1,877 Maryland Prepaid Trust Accounts.

**State Revenues:** The bill expands eligibility for the college savings plans income tax subtraction modification by allowing the deduction for each individual who contributes to a qualified plan. As a result, general fund revenues may decrease by \$455,300 in fiscal 2017. **Exhibit 2** shows the estimated impact of the bill on State and local revenues.

**Exhibit 2**  
**State and Local Revenue Impacts**  
**Fiscal 2017-2021**

	<u>FY 2017</u>	<u>FY 2018</u>	<u>FY 2019</u>	<u>FY 2020</u>	<u>FY 2021</u>
State	(\$455,300)	(\$469,000)	(\$483,100)	(\$497,600)	(\$517,700)
Local	(287,600)	(296,200)	(305,100)	(320,500)	(327,000)
<b>Total Revenues</b>	<b>(\$742,900)</b>	<b>(\$765,200)</b>	<b>(\$788,200)</b>	<b>(\$818,100)</b>	<b>(\$844,700)</b>

This estimate is based on the amount of returns claiming the subtraction modification in tax year 2014 and the following assumptions:

- 10% of all accounts receive a contribution from an individual who is not the account holder;
- the average donation in each year is equal to \$500 and the full amount of the contribution is deducted in each year; and
- future year contributions increase by 3% annually.

**Local Revenues:** Local income tax revenues will decrease as a result of additional subtraction modifications claimed against the personal income tax. Local revenues will decrease by \$287,600 in fiscal 2017 and by \$327,000 in fiscal 2021, as shown in Exhibit 2.

---

### **Additional Information**

**Prior Introductions:** None.

**Cross File:** SB 374 (Senator Serafini) - Budget and Taxation.

**Information Source(s):** College Savings Plans Network, Comptroller's Office, College Savings Plans of Maryland, U.S. Government Accountability Office, National Conference of State Legislatures, Department of Legislative Services

**Fiscal Note History:** First Reader - February 5, 2016  
md/jrb

---

Analysis by: Robert J. Rehrmann

Direct Inquiries to:  
(410) 946-5510  
(301) 970-5510