

**Department of Legislative Services**  
 Maryland General Assembly  
 2019 Session

**FISCAL AND POLICY NOTE**  
**First Reader**

House Bill 525 (Delegate Ebersole, *et al.*)  
 Ways and Means

**State Income Tax - Subtraction Modification - Elementary and Secondary Education Expenses**

This bill prohibits an individual from claiming the State income subtraction modification for contributions made to the Maryland College Investment Plan if the contributed funds are used for elementary or secondary education expenses as allowed under the Internal Revenue Code (IRC). The bill also prohibits an individual from claiming a subtraction modification for a distribution from the Maryland College Investment Plan or Maryland Prepaid Trust if the distribution is used for these expenses. **The bill takes effect July 1, 2019, and applies to tax year 2019 and beyond.**

**Fiscal Summary**

**State Effect:** Prohibiting individuals from claiming the subtraction modifications will increase revenues beginning in FY 2020. Based on estimates from the Comptroller’s Office, general fund revenues will increase by \$20.3 million annually beginning in FY 2020. Expenditures are not affected.

(\$ in millions)	FY 2020	FY 2021	FY 2022	FY 2023	FY 2024
GF Revenue	\$20.3	\$20.3	\$20.3	\$20.3	\$20.3
Expenditure	0	0	0	0	0
Net Effect	\$20.3	\$20.3	\$20.3	\$20.3	\$20.3

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

**Local Effect:** Local revenues may increase by \$10.8 million annually beginning in FY 2020. Local expenditures are not affected.

**Small Business Effect:** None.

## Analysis

### Current Law:

#### *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 higher education expenses. Accounts and plans must satisfy the income tax and transfer rules established under Section 529 of the IRC.

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 the qualified higher education expense of a beneficiary. These tax advantages are similar to the federal tax treatment of Roth IRAs.

The federal Tax Cuts and Jobs Act of 2017 (Public Law 115-97) was signed into law on December 22, 2017, and expands the permissible use of 529 plans by amending qualified higher education expense to include expenses for tuition in connection with enrollment or attendance at an elementary or secondary public, private, or religious school.

An account holder can withdrawal up to \$10,000 in each year for expenses associated with enrollment at these schools. This limitation applies to each beneficiary rather than a per account basis – although an individual may be the designated beneficiary of multiple accounts, that individual may receive a maximum of \$10,000 in distributions free of tax, regardless of whether the funds are distributed from multiple accounts. Any excess distribution will be treated as a distribution subject to tax under the general rules of Section 529.

The federal Act applies to distributions made after December 31, 2017.

#### *Maryland 529 Plans*

The College Savings Plans of Maryland Board currently operates two qualified tuition plans: the Maryland Prepaid College Trust and the Maryland College Investment Plan. 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.

## *State Taxation of 529 Plans*

### *Account Contributions*

In addition to the federal tax benefits available to 529 plans, the State allows a person to claim a subtraction modification for the advanced amount of tuition payments made to the Maryland Prepaid College Trust or amount contributed to the Maryland College Investment Plan. The subtraction modification claimed by a taxpayer may not exceed \$2,500 for each contract purchased (Maryland Prepaid College Trust) or \$2,500 per beneficiary (Maryland College Investment Plan). This limitation is increased to \$5,000 for married individuals who file jointly.

Any unused amount of the subtraction modification can be carried forward to future tax years until the full amount of the excess is used under the Maryland Prepaid College Trust and up to 10 tax years for contributions to the Maryland College Investment Plan.

The College Affordability Act of 2016 (Chapters 689 and 690) established a State matching contribution for qualified Maryland College Investment Plan accounts. An investment account holder is not eligible for the subtraction modification for contributions to an investment account in any year in which the account holder receives funds under the program.

### *Account Withdrawals*

The State generally conforms to the federal income tax treatment of qualified 529 withdrawals – qualified distributions that are not subject to federal tax are also exempt from state taxes. A person may also claim a subtraction modification for income as a result of a distribution to a qualified beneficiary to the extent the income is included in federal adjusted gross income.

## **Background:**

### *State College Investment Plans*

**Exhibit 1** shows the number of resident tax returns that claimed the college savings 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.

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

<b><u>FAGI</u></b>	<b><u>Total Tax</u></b>	<b><u>Number</u></b>	<b><u>% of All</u></b>	<b><u>Average</u></b>
	<b><u>Returns</u></b>		<b><u>Returns</u></b>	<b><u>Claim</u></b>
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

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**State Revenues:** The bill prohibits an individual from claiming the subtraction modification for contributions made to the Maryland College Investment Plan if the funds are used for elementary or secondary education expenses as allowed under the IRC. This change is effective beginning with tax year 2019.

In its estimate of the federal Tax Cuts and Jobs Act of 2017 on State revenues and taxpayers, the Comptroller's Office estimated that the expansion of 529 plans to primary and secondary school expenses as enacted by the federal Act will reduce State income tax revenues by \$14.1 million in tax year 2018 and by \$20.3 million annually thereafter. This estimated revenue impact was incorporated into the Board of Revenue Estimates' March 2018 State revenue forecast.

Based on this information, the bill will increase general fund revenues by \$20.3 million annually beginning in fiscal 2020. The estimated revenue impact assumes that the Comptroller's Office will identify and disallow any subtraction modifications that are claimed for contributions made for ineligible primary and secondary school expenses.

The bill also prohibits an individual from claiming a subtraction modification for a distribution from the Maryland College Investment Plan or Maryland Prepaid Trust if the

distribution is used for elementary or secondary education expenses. Given that a qualified distribution for these expenses is exempt from federal taxation, this provision will generally prevent individuals from claiming the State subtraction modification for nonqualified distributions and any revenue impact is not expected to be significant.

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### **Additional Information**

**Prior Introductions:** HB 644 of 2018 received a hearing in the House Ways and Means Committee, but no further action was taken.

**Cross File:** SB 753 (Senators Lam and Young) - Budget and Taxation.

**Information Source(s):** Comptroller's Office; Department of Legislative Services

**Fiscal Note History:** First Reader - February 18, 2019  
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