S.B. 125
133rd General Assembly

Fiscal Note & Local Impact Statement

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Version: As Passed by the Senate

Primary Sponsors: Sens. Hottinger and Brenner

Local Impact Statement Procedure Required: Yes

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Highlights

- The bill expands the applicability of an existing personal income tax deduction for the state-sponsored college savings plan to include investment offerings of other states.
- Two other states, Kansas and Montana, enacted similar legislation, which increased the number of tax returns claiming their respective state tax deductions by about 50%. A similar increase in Ohio would decrease annual GRF tax receipts by $9.9 million or more. However, it remains unclear whether the experiences in those two states can be generalized to Ohio. A third state, Missouri, enacted analogous legislation in 2008, but does not have taxpayer data to enable an evaluation of the behavioral effect.
- The GRF would bear 96.62% of any revenue loss under the income tax during the current biennium, while the Local Government Fund and Public Library Fund would bear 1.68% and 1.7%, respectively, of any such revenue loss.

Detailed Analysis

Continuing Ohio law allows a state income tax deduction for contributions to Ohio's 529 plan, which is a tax-preferred education savings program administered by the Ohio Tuition Trust Authority (OTTA). The bill extends the deduction so that it would also apply to contributions to any 529 plan established by another state or by an educational institution beginning with tax year (TY) 2019.

A 529 college savings program is a state-operated investment plan named after the section of the federal Internal Revenue Code (IRC) that specifies the various tax advantages of participating in the program. These tax advantages include tax-free growth while the value of the account accumulates, and withdrawals that are exempt from both federal and state income taxes if the distributions are used to pay for qualified higher education expenses. The qualified expenses include tuition, room and board, and any other fees or costs that are required for enrollment or attendance at the college or university. Funds invested in the CollegeAdvantage Savings Plan, which is the 529 savings plan administered by OTTA, may be used at any college in the country.

Federal tax law changes made in the Tax Cuts and Jobs Act (TCJA), H.R. 1 of the 115th Congress, permitted 529 account owners to use distributions from 529 plans to pay public or private elementary and secondary school ("K-12") tuition and related educational expenses. Annual withdrawals for K-12 expenses were capped at $10,000 per student by the TCJA. S.B. 22 of the 132nd General Assembly conformed state law to the federal government's expanded definition of eligible 529 plan expenditures. Consequently, taxpayers may claim a personal income tax (PIT) deduction on their state tax return for contributions supporting previously ineligible education expenses.

Fiscal effect

A handful of states permit a state income tax deduction on behalf of contributions to other states' 529 plans. LBO research indicates that Kansas, Missouri, and Montana enacted laws with provisions analogous to S.B. 125, which expanded their state's eligibility to all qualified tuition savings plans authorized by section 529 of the IRC. On the other hand, Arizona, Arkansas, Minnesota, and Pennsylvania permit deductions for contributions to other states' 529 plans, but multistate eligibility was enacted at the inception of their states' respective tax deduction policies. Therefore, the behavioral response of taxpayers to the bill's policy change can only be observed from Kansas (TY 2007), Missouri (TY 2008), and Montana (TY 2013) beginning with the year their respective state laws changed. LBO contacted officials in Missouri about their income tax data, but they recently implemented new database software and could not provide detailed statistics about their tax deduction claims in prior years.

State Income Tax Deductions Claimed for 529 College Savings Plan Contributions, As Reported by Other States Enacting Legislation Similar to S.B. 125 of the 133rd General Assembly

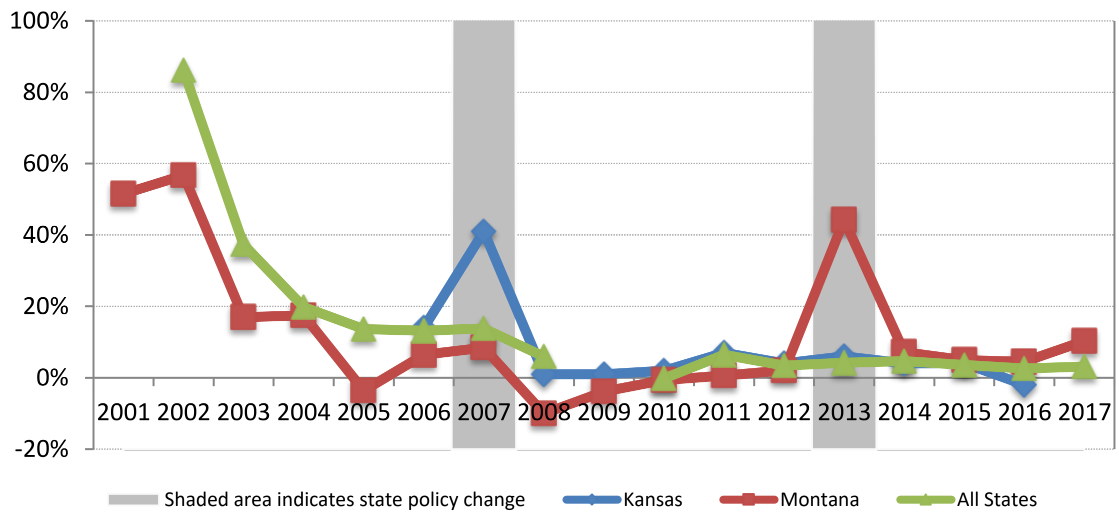
	Kansas	Montana
Number of tax returns (three-year average) claiming deduction, prior to law change	13,890	2,113
Number of tax returns (three-year average) claiming deduction, after law change	21,100	3,300
Increase after law change	**7,210 (51.9%)**	**1,187 (56.2%)**

Note: Kansas only published state tax deduction statistics about 529 plan contributions for two years prior to changing its law to permit deductions for contributions to plans sponsored by other states.

Prior to TY 2018, contributions to college savings plans could only be withdrawn without penalty for college tuition and other associated expenses. As mentioned above, the TCJA and S.B. 22 expanded the definition of eligible expenditures to include K-12 tuition. For this reason, the TY 2017 statistics are the best baseline against which S.B. 125 should be estimated. In that year, PIT data shows that 114,103 tax returns claimed $334.6 million in deductions, or $2,932 per return. The TY 2017 returns were largely filed during FY 2018, reducing GRF receipts by $12.4 million due to the existing college savings plan deduction.[1]

If the experiences in Kansas and Montana were replicated in Ohio, S.B. 125 would spur an additional 59,228 tax returns to claim the college savings plan deduction. However, the college savings plan deduction was limited to $2,000 per beneficiary in TY 2017 whereas the current limit in continuing law is $4,000 per beneficiary. LBO previously estimated the annual GRF loss for the provision[2] that increased the contribution limit to $4,000 per beneficiary to be approximately $6.7 million. Therefore, the estimated annual revenue loss incurred for all tax deductible contributions to college savings plans is nearly $19.1 million per year. If S.B. 125 increases the number of tax returns by 52%, the bill could decrease GRF receipts by $9.9 million per year.

Annual Growth in Number of Tax Returns Claiming State Tax Deduction for 529 Contributions, as Compared to National Growth in Number of 529 Accounts



Note: "All states" number of 529 accounts collected prior to 2009 is not comparable due to change in methodology, from https://www.collegesavings.org/529-plan-data/.

Potential revenue losses could be higher depending on the behavioral response of those taxpayers that claim the college savings plan deduction for K-12 contributions after the enactment of the TCJA. The Ohio tax department estimated this K-12 provision would nearly double the size of the state tax expenditure as compared to when it solely applied to higher education costs. Statistics concerning this behavioral response are not yet available as TY 2018 tax returns were due ten months prior to the writing of this fiscal note. If the number of taxpayers utilizing the K-12 aspect in TY 2018 increase substantially (i.e., nearly 52%) in TY 2019

[1] Estimate according to the Tax Expenditure Report, which is released in conjunction with the executive budget proposal.

[2] Refer to the comparison document for H.B. 49 of 132nd General Assembly.

and years thereafter due to S.B. 125, then the GRF revenue loss could grow by another $8.5 million for a total annual revenue loss of $18.4 million.

Additional qualitative factors about Ohio's state-sponsored college savings plans are not explicitly incorporated in this revenue estimate. However, the experiences in Montana and Kansas may not be entirely comparable, as Ohio's CollegeAdvantage 529 Savings Plan is highly rated by independent analysts. Morningstar, which publishes research and recommendations for financial investments, annually evaluates college savings plans sponsored by states across the country. In its 2019 report, Morningstar "identified 30 best-in-class plans, assigning these programs Analyst Ratings of Gold, Silver, or Bronze."[3] The CollegeAdvantage 529 Savings Plan issued by OTTA was among 13 plans to be rated "Silver," and only four plans earned the higher "Gold" rating. The implication for S.B. 125 is that Ohio taxpayers may not favor out-of-state plans much more than OTTA's offerings. Since Ohio's plan is highly rated and usable at any college in the country, the behavioral response to S.B. 125 may be diminished, as compared to experiences in Kansas and Montana.

The immediate beneficiaries of S.B. 125 may be those Ohio taxpayers that previously opened 529 accounts sponsored by other states. Taxpayers may have established these accounts when previously living in a different state or instead elected to contribute to other state-sponsored plans based on their individual preferences.

Although S.B. 125 first applies to TY 2019, it is unlikely to reduce revenues in FY 2020 because the bill's effective date occurs after the PIT payment deadline of April 15, 2020. Consequently, the FY 2021 revenue impact could include an additional, one-time cost prompted by those who file amended tax returns to deduct their TY 2019 contributions. The GRF would bear 96.62% of any revenue loss under the income tax during the biennium beginning July 1, 2019, while the Local Government Fund (LGF) and Public Library Fund (PLF) would bear 1.68% and 1.7%, respectively, of any such revenue loss. Under current law, the LGF and PLF shares of GRF tax revenue would revert to their shares specified in codified law, both 1.66%, beginning July 1, 2021.

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[3] https://www.morningstar.com/articles/950079/rating-the-top-529-college-savings-plans.