OHIO LEGISLATIVE SERVICE COMMISSION

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Office of Research and Drafting

Legislative Budget Office

S.B. 125
133rd General Assembly

Fiscal Note & Local Impact Statement

Click here for S.B. 125's Bill Analysis

Version: As Reported by House Ways and Means

Primary Sponsors: Sens. Hottinger and Brenner

Local Impact Statement Procedure Required: Yes

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Highlights

529 education savings plan income tax deductions

- 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 96.68% of any revenue loss under the income tax during the first year, FY 2024, taxpayers will claim the expanded deduction, while the Local Government Fund and Public Library Fund would bear 1.66% and 1.66%, respectively, of any such revenue loss.

Higher education tuition and fee waivers

- The Department of Higher Education's (DHE) reimbursements to institutions of higher education under the Ohio Safety Officer's Memorial Fund Program (OSOMF) may increase due to the bill's extension of residency status to certain individuals and inclusion of certificate programs as an eligible option. The overall amount that reimbursements increase will depend on (1) the number of newly eligible individuals who take advantage of the provisions in a fiscal year, (2) the type of institution in which the individual enrolls, and (3) the maximum amount DHE authorizes for reimbursement.

- State institutions of higher education that enroll newly eligible students under the bill's extended tuition waiver policy may receive less revenue under the bill since they will no longer be able to apply an out-of-state surcharge for these individuals.
- Conversely, the tuition waiver offered under the bill may incentivize some of these students to enroll in state institutions, which would increase state reimbursement revenues as well as instructional costs at those institutions.

Detailed Analysis

529 education savings plan income tax deductions

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) 2023.

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.

Table 1. 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.

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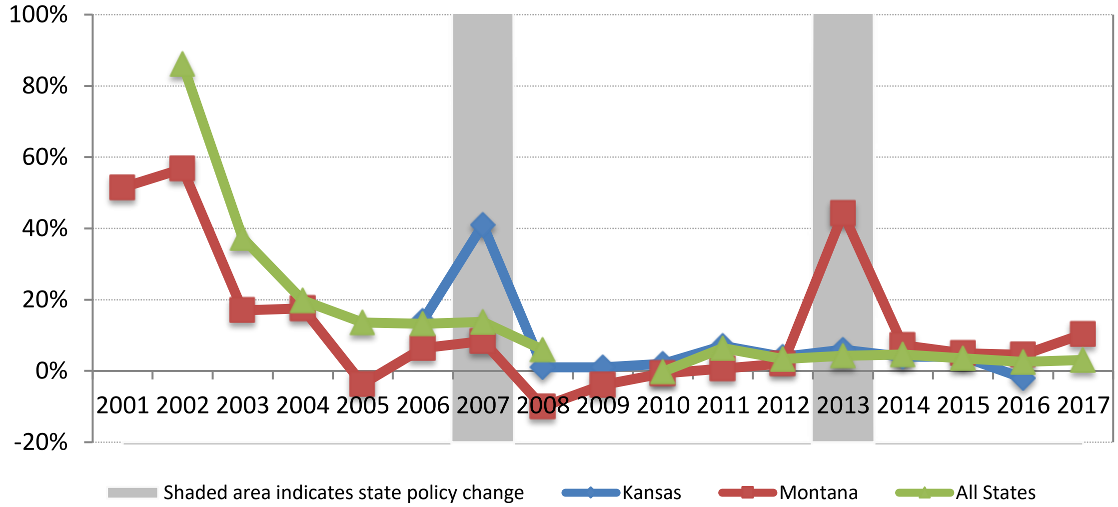
[1] Estimate according to the Tax Expenditure Report, which is released in conjunction with the executive budget proposal.

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

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 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.

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

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.

S.B. 125 first applies to TY 2023. Under current law, the GRF would bear 96.68% of any revenue loss under the income tax during the biennium beginning July 1, 2021, while the Local Government Fund (LGF) and Public Library Fund (PLF) would bear 1.66% and 1.66%, respectively, of any such revenue loss.

Higher education tuition and fee waivers

The bill extends permanent Ohio residency status to qualify for a waiver of postsecondary tuition and fees for the child, spouse, or qualified former spouse of a public service officer or U.S. armed services member killed in the line of duty, if the child or spouse was an Ohio resident when the public service officer or service member was killed. Under current law, a recipient must be a current Ohio resident. In addition, the bill qualifies an eligible child, spouse, or qualified former spouse of a public safety officer or U.S. armed service member killed in the line of duty for a waiver of postsecondary tuition and fees for a certificate program at a state institution of higher education or a participating private educational institution and limits the waiver on a per-student basis to two total certificate programs, a total number of academic credits or instructional hours equivalent to four academic years, and $8,000 worth of tuition and fees in a particular academic year. The following discusses the potential fiscal effects of the bill, beginning with some background on the Ohio Safety Officers Memorial Fund (OSOMF) Program.

Program background

Continuing law provides an eligible child, spouse, or qualified former spouse of a qualified public service officer or U.S. armed services member killed in the line of duty with a waiver of undergraduate tuition and fees at state institutions of higher education and reduced tuition and fees at participating private nonprofit and for-profit educational institutions. In addition to the residency requirement noted above, a child must also be either under 26 years old or, if honorably discharged from the armed forces, under 30 years old. Eligible students can receive a waiver or reduction in tuition for up to five years (ten semesters or 15 quarters) or until a bachelor's degree is obtained, whichever comes first. The Department of Higher Education (DHE) provides reimbursement to institutions for the tuition and fees that are waived.

Participation

According to DHE, approximately 40 students per year received tuition and fee waivers from FY 2016 through FY 2020, the latest year for which this data is available. Table 2 below shows the number of recipients by each institutional sector from FY 2016 through FY 2020. As the table shows, approximately 83% of the qualifying students over this time were enrolled at public universities and community colleges.

Table 2. OSOMF Recipients by Institutional Sector, FY 2016-FY 2020					
Institutional Sector	**FY 2016**	**FY 2017**	**FY 2018**	**FY2019**	**FY 2020**
Public universities and colleges	35	32	31	33	40
Private, nonprofit	7	8	7	6	6
Private, for-profit	1	0	0	0	0
Total	**43**	**40**	**38**	**39**	**46**

The number of individuals newly eligible that will participate under the bill is uncertain. Nevertheless, the number will likely be less than the current enrollment numbers reported, most notably due to the unique circumstances of a family member moving out of state and then returning to the state to enroll at a university or college in Ohio.

Reimbursements

H.B. 166, the current main operating budget act, requires DHE's reimbursements to institutions under OSOMF to be paid from GRF line item 235563, Ohio College Opportunity Grant (OCOG), prior to determining OCOG award grants for the academic year. According to its website, DHE is providing benefits to cover 100% instructional and general fee charges at public colleges and universities and $8,451 per year at private and proprietary postsecondary institutions in the 2020-2021 academic year.[4] As seen in Table 3 below, DHE reimbursed approximately $386,000 to institutions under the program in FY 2020. Like the number of participants described above, approximately 83% of the approximately $1.6 million reimbursed to the state's institutions of higher education from FY 2016 through FY 2020 was distributed to public universities and community colleges.

Table 3. OSOMF Reimbursements by Institutional Sector, FY 2016-FY 2020					
Institutional Sector	**FY 2016**	**FY 2017**	**FY 2018**	**FY 2019**	**FY 2020**
Public universities and colleges	$252,605	$211,314	$234,679	$261,206	$338,034
Private, nonprofit	$62,832	$66,273	$49,308	$36,670	$47,652
Private, for-profit	$9,020	$0	$0	$0	$0
Total	**$324,457**	**$277,586**	**$283,987**	**$297,876**	**$385,686**

[4] https://www.ohiohighered.org/safety-officers-college-fund.

As a result of the bill, DHE's reimbursements from item 235563 may increase. The amount of that increase and, accordingly, the payments received by institutions, will depend on the following factors: (1) the number of individuals who participate in a fiscal year, (2) the type of institution the individual enrolls at, and (3) the maximum amount DHE authorizes for reimbursement. As a point of reference, DHE's reimbursements to institutions for traditional programs averaged $8,384 per recipient ($385,686 / 46 recipients) in FY 2020.

Tuition revenues

State institutions generally can charge a higher tuition rate to out-of-state students than they can for in-state students. Under the bill, state institutions will receive less revenue for the newly eligible nonresident participant that would have otherwise attended the institution at out-of-state tuition rates because the student does not "reside" in Ohio. Table 4 below shows that, in FY 2021, the average in-state tuition and general fees for undergraduate students enrolled at the main campus of one of the state's 13 public four-year universities is $10,076, while the average out-of-state undergraduate tuition and general fees charged to a student is $19,954. The difference, $9,878, represents the average amount of the annual revenue loss per traditional student at those locations due to the bill if it was in place in FY 2021. The difference would be less for students that attend community and technical colleges. The annualized in-state rate at those institutions averaged $5,012 while the out-of-state rate averages $10,246, for an average difference of $5,234.

Table 4. Average Annualized Undergraduate Tuition by Residency and Status, FY 2021

Sector	Average Out-of-State Undergraduate Tuition and General Fees	Average In-State Undergraduate Tuition and General Fees	Difference
University main campuses	$19,954	$10,076	$9,878
University regional branches	$16,708	$6,120	$10,588
Community colleges	$10,246	$5,012	$5,234

On the other hand, waiving tuition for these students may provide an incentive for them to attend Ohio institutions. That is, the proposal may attract some students to Ohio institutions that otherwise would not have enrolled. Ultimately, the proposal's fiscal impact on state institution revenues will depend on the type of institution the students attend and the mix of eligible students that (1) would have paid out-of-state tuition rates to attend an Ohio institution before establishing residency and (2) would not have attended an Ohio institution but for the bill's policy. Any increase in reimbursement revenue as a result of additional students will be offset, at least in part, by the cost to educate the new students.

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