



## Legislative Fiscal Bureau

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TO: Members  
Joint Committee on Finance

FROM: Bob Lang, Director

SUBJECT: Assembly Bill 31 and Senate Bill 293: Individual Income Tax Deductions for College Savings Programs

Assembly Bill 31 and Senate Bill 293 are companion bills that would expand a current individual income tax deduction for certain amounts paid into an account in a Wisconsin college savings program to include such amounts paid into any college savings program. AB 31 was introduced on January 25, 2005, and referred to the Assembly Committee on Colleges and Universities and to the Joint Survey Committee on Tax Exemptions. On March 30, 2005, the Committee on Colleges and Universities voted to recommend passage of AB 31 on a vote of 8 to 3. The bill was then referred to the Joint Committee on Finance. SB 293 was introduced on August 19, 2005, and referred to the Joint Committee on Finance.

### **CURRENT LAW**

#### **Federal Law**

As provided under federal law, a qualified tuition program (QTP), also known as a section 529 plan (in reference to the section of the Internal Revenue Code authorizing such plans), is a program that allows individuals to either purchase pre-paid tuition units or to contribute to a college savings account established for paying a student's qualified education expenses at an eligible educational institution. A QTP can be established and maintained by a state, or an agency or instrumentality of a state, and by an eligible educational institution. For programs satisfying the federal QTP requirements, federal law has provided an individual income tax exemption for earnings in and distributions from (but not contributions to) QTPs established by states since tax year 2002. Effective with tax year 2004, the federal exemption was extended to earnings in and distributions from QTPs offered by eligible private institutions in addition to state-sponsored plans.

## **State Law**

Current law authorizes two types of Wisconsin section 529 programs. The first program is a pre-pay plan, under which an individual may purchase tuition units for a designated beneficiary. This program, sometimes referred to as EdVest I, was started in 1997 and is administered by the State Treasurer's office with investments managed by the State of Wisconsin Investment Board.

The second type of section 529 plan authorized by the state is the college savings account program, under which individuals make payments into a college savings account approved by the 11-member College Savings Program Board on behalf of a designated beneficiary (rather than purchasing tuition units). The College Savings Program Board has approved college savings accounts offered through EdVest, referred to as EdVest II, as well as through Tomorrow's Scholar, which is managed by American Express. Section 529 college savings accounts were first offered by the state in May, 2001.

State statutes continue to authorize both the tuition unit type of section 529 programs (offered through EdVest I) and the college savings account type of section 529 programs (offered through EdVest II and Tomorrow's Scholar). However, as a result of the greater complexity of the tuition unit option and following a decline in public interest in purchasing tuition units, EdVest I was closed to new investments, effective December 20, 2002.

State tax law conforms to the federal provisions providing an exemption from income for earnings in, and qualified distributions from, state approved section 529 plans. In addition, for state tax purposes, donors have been permitted to deduct up to \$3,000 in amounts paid into a Wisconsin section 529 plan if the beneficiary is the purchaser, the purchaser's spouse (for a married couple filing a joint tax return), or the purchaser's dependent child. Under 2001 Wisconsin Act 109, the deduction for amounts paid into Wisconsin section 529 accounts was extended to grandparents of a beneficiary, effective with tax year 2002. Under 2003 Wisconsin Act 289, effective January 1, 2004, the deduction was again expanded, this time to include amounts paid by great-grandparents, aunts, and uncles of account beneficiaries. The annual deduction for amounts paid into one or more state approved section 529 account for a specific beneficiary is limited to \$3,000 per claimant. A married couple filing a joint return is considered one claimant.

## **SUMMARY OF BILLS**

AB 31 and SB 293 would expand the current law income tax deduction for amounts paid on behalf of beneficiaries by certain individuals to a Wisconsin section 529 plan to include such amounts paid into any section 529 plan. Therefore, under the bills, claimants would be permitted to deduct up to \$3,000 in amounts paid into a section 529 plan offered through EdVest or Tomorrow's Scholar, through another state, or through an eligible private institution if the beneficiary is the purchaser, the purchaser's spouse (for a married couple filing a joint tax return), or the purchaser's

dependent child or if the purchaser is the beneficiary's grandparent, great-grandparent, aunt, or uncle. As under current law, the maximum annual deduction per claimant on behalf of a specific beneficiary would be limited to \$3,000, even if the claimant paid into more than one plan on behalf of such beneficiary.

These provisions would first apply to taxable years beginning on January 1 of the year in which the bills take effect, unless the bills take effect after July 31, in which case the provisions would first apply to taxable years beginning on January 1 of the following year. The bills' effective date would be the day after publication.

## **FISCAL EFFECT**

Based on information provided by the College Savings Plan Network, other states' college savings plan programs, and Wisconsin's EdVest program, it is estimated that the proposal would reduce Wisconsin individual income tax collections by \$7.0 million in 2006-07. This estimate assumes that the proposal would first apply to tax year 2006.

Historical data provided by the College Savings Plan Network reveals strong annual growth in the number of section 529 accounts; a report dated June 30, 2005, indicated that there were 7.5 million accounts in state-sponsored section 529 plans, which was approximately 10% more than the 6.8 million accounts reported on June 30, 2004. If strong growth in the number of such plans continues, as is expected, then the fiscal effect of AB 31/SB 293 in subsequent years would be correspondingly higher than the estimate provided for 2006-07.

The estimated fiscal effect provided above (a reduction in tax revenues of \$7.0 million in 2006-07) is higher than the \$6.1 million reduction estimated by the Department of Revenue on March 2, 2005, for two reasons: (a) the current estimate is based on more recent data from the College Savings Plan Network as to the current number of section 529 plans nationwide; and (b) the current estimate assumes that the provision would first apply to tax year 2006, while the estimate provide in March, 2005, by DOR had assumed that the provision would first apply to tax year 2005.

It should be noted that the estimated gross balance in the state's general fund for 2006-07 is \$70.4 million. If AB 31/SB 293 were to be enacted, the estimated balance would be reduced to \$63.4 million.

Section 20.003(4) of the statutes indicates that "no bill directly or indirectly affecting general purpose revenues...may be enacted by the Legislature if the bill would cause the estimated general fund balance on June 30 of any fiscal year...to be an amount equal to less than...for fiscal year 2006-07, \$65,000,000."

In addition, s. 20.003(4m) of the statutes indicates that "no bill may be adopted by the Legislature if the bill would cause in any fiscal year total expenditures...to exceed taxes and departmental revenues..." This provision applies to the general fund. Adoption by the Legislature of AB 31/SB 293 would cause general fund expenditures to exceed taxes and departmental revenues by \$1.9 million in 2006-07.

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