HOUSE OF REPRESENTATIVES
TWENTY-EIGHTH LEGISLATURE, 2016
STATE OF HAWAII

H.B. NO. 2519

A BILL FOR AN ACT

RELATING TO COLLEGE SAVINGS PROGRAM TAX DEDUCTION.

BE IT ENACTED BY THE LEGISLATURE OF THE STATE OF HAWAII:

SECTION 1. Chapter 235, Hawaii Revised Statutes, is amended by adding a new section to be appropriately designated and to read as follows:

"**§235- College savings program tax deduction** (a) The following annual deductions from gross income shall be allowed for contributions made to a designated beneficiary's Hawaii college savings program account established pursuant to chapter 256:

(1) Up to $5,000 for individual taxpayers, but not more than the amount contributed during the taxable or prior year as provided in this section;

(2) Up to $5,000 for married couples filing separate returns, but not more than the amount contributed during the taxable or prior year as provided in this section; provided that each spouse may claim a deduction of up to $5,000; and

(3) Up to $10,000 for married couples filing joint returns, individuals filing as the head of the household, or individuals filing as surviving spouses, but not more than the amount contributed during the taxable or prior year as provided in this section;

(b) If the amount of the deduction exceeds the taxpayer's taxable income for the taxable year the contribution is made, or if the amount contributed to the college savings program account exceeds the amount allowed to be deducted during the year of contribution, the contribution in excess of the deductible amount may be used as a deduction against the taxpayer's taxable income for up to five subsequent tax years or until the excess deduction is exhausted, whichever occurs first.

(c) Amounts deducted shall be for contributions made by December 31 of the tax year. No deduction shall be allowed for any amounts derived from a withdrawal or rollover from another qualified tuition program created pursuant to section 529 of the Internal Revenue Code of 1986, as amended. No deduction shall be allowed for contributions to an account made in the same tax year that a nonqualified withdrawal from that account has occurred. Any deduction taken under this section shall be subject to recapture in any taxable year in which any nonqualified withdrawal is made.

(d) For the purposes of this section, "nonqualified withdrawal" has the same meaning as in section 256-1."

SECTION 2. New statutory material is underscored.

SECTION 3. This Act, upon its approval, shall apply to taxable years beginning after December 31, 2015.

INTRODUCED BY:

JAN 26 2016

H.B. NO. 2519

Report Title:
College Savings Program Tax Deduction; 529 Plans

Description:
Provides an annual maximum deduction of $5,000 per individual or $10,000 for a married couple filing jointly for contributions made to the Hawaii college savings program.

The summary description of legislation appearing on this page is for informational purposes only and is not legislation or evidence of legislative intent.

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To: The Honorable Isaac W. Choy, Chair
and Members of the House Committee on Higher Education

Date: February 4, 2016
Time: 2:00 P.M.
Place: Conference Room 309, State Capitol

From: Maria E. Zielinski, Director
Department of Taxation

Re: H.B. 2519, Relating to College Saving Program Tax Deduction

The Department of Taxation (Department) appreciates the intent of H.B. 2519, and offers the following comments for your consideration.

H.B. 2519 allows a deduction equal to a taxpayer’s annual contributions to a Hawaii college savings program account established pursuant to chapter 256, Hawaii Revised Statutes. The deduction is capped at $5,000 per year for single and married filing separately taxpayers, and $10,000 for married filing jointly, head of household, and surviving spouse taxpayers. The bill is effective upon approval and applies retroactively to tax years beginning after December 31, 2015.

First, the Department notes that section 529 education savings plans are already tax-favored at both the state and federal levels. All contributions to section 529 plans grow tax free and all qualifying withdrawals from those plans are received tax free. This bill would add another tax benefit to section 529 plans by making contributions tax deductible when made and then allowing those contributions to grow and be used tax free in the future.

Second, the Department is unsure as to how the limit on contributions would be applied. Specifically, it is unclear if a deduction of $5,000 ($10,000 if married) is available for each section 529 plan that a taxpayer contributes to, or if each taxpayer is limited to one deduction for all contributions. The Department suggests clarification of this provision.

Third, the first two lines of subsection (b) cannot be reconciled with the rest of subsection (b). As written, the Department is unclear as to intent of this provision.

Finally, the Department has concerns about the precision of the recapture provision in subsection (c). To clarify the operation of the recapture provision, the Department suggests the following language to replace the final sentence of subsection (c):

> "All deductions taken under this section shall be subject to recapture. Recapture of deductions taken under this section is triggered by any nonqualified withdrawal from the account to which the contribution was made. Any recapture under this section is equal to the amount of all nonqualified withdrawals during the taxable year and shall be added to the taxpayer's taxable income for the taxable year in which the recapture is triggered."

If the Legislature wishes to include a recapture provision for amounts deducted under this measure, the Department suggests that a penalty provision on nonqualified withdrawals also be added.

Thank you for the opportunity to provide comments.

TAX FOUNDATION OF HAWAII

126 Queen Street, Suite 304 Honolulu, Hawaii 96813 Tel. 536-4587

SUBJECT: INCOME, College Savings Program Deduction

BILL NUMBER: HB 2519

INTRODUCED BY: TAKAYAMA, CACHOLA, CREAGAN, DECOITE, HAR, ICHIYAMA, KAWAKAMI, KEOHOKALOLE, KONG, LOPRESTI, MIZUNO, NISHIMOTO, OHNO, OSHIRO, SAY, THIELEN, TOKIOKA, WOODSON, YAMASHITA

EXECUTIVE SUMMARY: Provides an annual maximum deduction of $5,000 per individual or $10,000 for a married couple filing jointly for contributions made to the Hawaii college savings program.

BRIEF SUMMARY: Adds a new section to HRS chapter 235 to provide a deduction for contributions made to a designated beneficiary's Hawaii college savings program account under HRS chapter 256.

The maximum deduction is $5,000 for individual taxpayers, but not more than the amount contributed during the taxable or prior year; $5,000 for married individuals filing separate returns, but not more than the amount contributed during the taxable or prior year, provided that each spouse may claim a deduction of up to $5,000; and $10,000 for married couples filing joint returns, individuals filing as the head of the household, or individuals filing as surviving spouses, but not more than the amount contributed during the taxable or prior year.

Any deduction in excess of the taxpayer's taxable income can be carried forward for up to five years.

Amounts deducted shall be for contributions made by December 31 of the tax year. No deduction shall be allowed for any amounts derived from a withdrawal or rollover from another qualified tuition program created pursuant to section 529 of the IRC. No deduction shall be allowed for contributions to an account made in the same tax year that a nonqualified withdrawal from that account has occurred. Any deduction taken under this section shall be subject to recapture in any taxable year in which any nonqualified withdrawal is made. Defines "nonqualified withdrawal" as the same as in HRS section 256-1.

EFFECTIVE DATE: Applies to taxable years beginning after December 31, 2015.

STAFF COMMENTS: Section 529 of the IRC provides special treatment for qualified tuition programs. Such plans are generally exempt from income tax, but contributions to them are generally not deductible because of the private benefit, namely the education of the donor's children or other family members. The IRC does provide favorable gift tax treatment in that any contributed amounts in excess of the annual gift tax exclusion may be spread over five years.

Act 81, SLH 1999, and Act 90, SLH 2000, established the Hawaii college savings account program in chapter 256, HRS. At the time, the intent was for the accounts established by this law to comply with section 529(b)(1) of the IRC.

This measure would allow taxpayers a deduction for contributions to a college savings account. Presumably, the social policy behind this deduction is to encourage higher education by giving an incentive to taxpayers who commit resources to higher education expenses.

Lawmakers need to remember two things. First, the tax system is the device that raises the money that they, lawmakers, like to spend. Using the tax system to shape social policy merely throws the revenue raising system out of whack, making the system less than reliable as there is no way to determine how many taxpayers will avail themselves of the deduction and in what amount. The second point to remember about tax deductions is that they are nothing more than the expenditure of public dollars, but out the back door. If, in fact, these dollars were subject to the appropriation process, would taxpayers be as kind about the expenditure of these funds when students are roasting in our primary schools, or when there isn't enough money for social service programs?

Utilizing tax deductions to drive social policy in this manner is of a questionable benefit relative to the cost for all taxpayers. A direct appropriation of grant funding to the colleges and universities would be more accountable and transparent. At least we would know the amount of the appropriation, while the fiscal impact of the deduction would be a great big question mark.

Furthermore, the additional credit would require changes to tax forms and instructions, reprogramming, staff training, and other costs that could be massive in amount compared to the benefit expected to accrue as a result of the deductible activity.

Digested 2/2/16

LATE

TESTIMONY BY WESLEY K. MACHIDA
DIRECTOR, DEPARTMENT OF BUDGET AND FINANCE
STATE OF HAWAII
TO THE HOUSE COMMITTEE ON HIGHER EDUCATION
ON
HOUSE BILL NO. 2519

February 4, 2016

RELATING TO COLLEGE SAVINGS PROGRAM TAX DEDUCTION

House Bill No. 2519, proposes to provide for an annual state income tax deduction of up to $5,000 per individual or $10,000 for a married couple filing jointly, against taxable income, for contributions made to a designated beneficiary's Hawaii college savings program account established pursuant to HRS chapter 256 and section 529 of the Internal Revenue Code (commonly known as 529 college savings plans).

The Department supports the intent of the bill to encourage and provide incentives for individuals and families to save funds for higher education. However, the proposed bill has a budgetary impact that is not included in the executive supplemental budget submittal; therefore, we cannot support the bill at this time. Based on 2,455 funded in-state accounts in the plan as of 12/31/2015 and Hawaii's top tax rate, a rough estimate of the tax revenue loss would be approximately $2.7 million, with a potential for higher loss assuming the number of accounts increase given a tax deduction.

Should such a tax deduction be considered, the Department would like to note that this would provide taxpayers with a double tax benefit. The first being the deduction from gross income when funds are contributed into a plan, and the second being the tax-free treatment of the investment income when withdrawn for qualified higher education expenses.

In closing, the Department recognizes that a tax deduction would provide a significant incentive to Hawai'i families to save for college but does not support the bill at this time due to its revenue impact.

Thank you for the opportunity to provide testimony on this bill.