S.B. NO. 940

JAN 2 5 2017

A BILL FOR AN ACT

RELATING TO THE STATE OF HAWAII SECTION 529 COLLEGE SAVINGS PROGRAM.

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

SECTION 1. In 2002, the State of Hawaii established a college savings program called "TuitionEDGE" pursuant to chapter 256, Hawaii Revised Statutes, and section 529 of the Internal Revenue Code of 1986, as amended. In November 2007, the program was revamped under a new program manager, and re-branded as "HI529 Hawaii's College Savings Program". The program was established and exists to assist and encourage families to save and invest funds for future higher education expenses. The investment income earned under the program is exempt from federal and State taxes; provided that the funds are used for qualified higher education expenses.

As of September 30, 2016, there were approximately 6,542 accounts (5,591 in-state and 951 out-of-state) in the program and $73,138,396 in program assets. The asset size of Hawaii's program is relatively small, and the participation rate is low compared to other states' college savings programs.

Most states offer some kind of in-state tax deduction or credit for contributions as an incentive for their residents to participate in their college savings programs. To provide an incentive to Hawaii taxpayers' to participate in the Hawaii program, and to increase the program's assets so that the State and program participants may be able to obtain a lower program management fee in the future, this bill provides a State income tax deduction for contributions to the program.

As the cost of higher education continues to rise, the tax deduction will also help Hawaii families save for college instead of having to take out educational loans. This income tax deduction will apply to program contributions made in calendar year 2018 and beyond.

SECTION 2. Section 235-7, Hawaii Revised Statutes, is amended by amending subsection (a) to read as follows:

"(a) There shall be excluded from gross income, adjusted gross income, and taxable income:

(1) Income not subject to taxation by the State under the Constitution and laws of the United States;

(2) Rights, benefits, and other income exempted from taxation by section 88-91, having to do with the state retirement system, and the rights, benefits, and other income, comparable to the rights, benefits, and other

income exempted by section 88-91, under any other public retirement system;

(3) Any compensation received in the form of a pension for past services;

(4) Compensation paid to a patient affected with Hansen's disease employed by the State or the United States in any hospital, settlement, or place for the treatment of Hansen's disease;

(5) Except as otherwise expressly provided, payments made by the United States or this State, under an act of Congress or a law of this State, which by express provision or administrative regulation or interpretation are exempt from both the normal and surtaxes of the United States, even though not so exempted by the Internal Revenue Code itself;

(6) Any income expressly exempted or excluded from the measure of the tax imposed by this chapter by any other law of the State, it being the intent of this chapter not to repeal or supersede any such express exemption or exclusion;

(7) Income received by each member of the reserve components of the Army, Navy, Air Force, Marine Corps, or Coast Guard of the United States of America, and

the Hawaii National Guard as compensation for performance of duty, equivalent to pay received for forty-eight drills (equivalent of twelve weekends) and fifteen days of annual duty, at an:

(A) E-1 pay grade after eight years of service; provided that this subparagraph shall apply to taxable years beginning after December 31, 2004;

(B) E-2 pay grade after eight years of service; provided that this subparagraph shall apply to taxable years beginning after December 31, 2005;

(C) E-3 pay grade after eight years of service; provided that this subparagraph shall apply to taxable years beginning after December 31, 2006;

(D) E-4 pay grade after eight years of service; provided that this subparagraph shall apply to taxable years beginning after December 31, 2007; and

(E) E-5 pay grade after eight years of service; provided that this subparagraph shall apply to taxable years beginning after December 31, 2008;

(8) Income derived from the operation of ships or aircraft if the income is exempt under the Internal Revenue Code pursuant to the provisions of an income tax

treaty or agreement entered into by and between the United States and a foreign country, provided that the tax laws of the local governments of that country reciprocally exempt from the application of all of their net income taxes, the income derived from the operation of ships or aircraft that are documented or registered under the laws of the United States;

(9) The value of legal services provided by a prepaid legal service plan to a taxpayer, the taxpayer's spouse, and the taxpayer's dependents;

(10) Amounts paid, directly or indirectly, by a legal service plan to a taxpayer as payment or reimbursement for the provision of legal services to the taxpayer, the taxpayer's spouse, and the taxpayer's dependents;

(11) Contributions by an employer to a legal service plan for compensation (through insurance or otherwise) to the employer's employees for the costs of legal services incurred by the employer's employees, their spouses, and their dependents;

(12) Amounts received in the form of a monthly surcharge by a utility acting on behalf of an affected utility under section 269-16.3; provided that amounts retained

by the acting utility for collection or other costs shall not be included in this exemption;

(13) Amounts received in the form of a cable surcharge by an electric utility company acting on behalf of a certified cable company under section 269-134; provided that any amounts retained by that electric utility company for collection or other costs shall not be included in this exemption; [~~and~~]

(14) One hundred per cent of the gain realized by a fee simple owner from the sale of a leased fee interest in units within a condominium project, cooperative project, or planned unit development to the association of owners under chapter 514A or 514B, or the residential cooperative corporation of the leasehold units.

For purposes of this paragraph:

"Fee simple owner" shall have the same meaning as provided under section 516-1; provided that it shall include legal and equitable owners;

"Legal and equitable owner", and "leased fee interest" shall have the same meanings as provided under section 516-1; and

"Condominium project" and "cooperative project" shall have the same meanings as provided under section 514C-1[~~.~~]; and

(15) Contributions to an account in the Hawaii college savings program provided under chapter 256.

(A) The annual deductions for such contributions shall be:

(i) Up to $5,000 for individual taxpayers;

(ii) Up to $10,000 for married couples filing separate returns; provided that each spouse may claim a deduction up to $5,000; and

(iii) Up to $10,000 for married couples filing joint returns, individuals filing as the head of households, or individuals filing as surviving spouses; provided that the deduction shall be available to married couples filing joint returns if at least one spouse is an account owner in the Hawaii college savings program;

provided that only a Hawaii taxpayer who is an account owner in the Hawaii college savings program shall be allowed to claim the above applicable deduction for contributions made by the taxpayer into the taxpayer's account in the Hawaii college savings program.

(B) In order to be deductible for a particular taxable year, a contribution shall be credited to the account of the Hawaii taxpayer on or before the last day of that taxable year; provided that if a contribution is mailed in, it shall be postmarked on or before the last day of that taxable year.

(C) Rollovers from another state's college savings program into Hawaii's college saving program shall not be considered to be contributions eligible for the State tax deduction under this paragraph.

(D) If the amount of the State tax deduction exceeds the Hawaii taxpayer's taxable income for the taxable year the contribution is made, the excess deduction may be used as a deduction against the taxpayer's taxable income in subsequent tax years until the excess deduction is exhausted.

(E) Contributions to the Hawaii college savings program that have been deducted from the Hawaii taxpayer's adjusted gross income for prior tax years shall be subject to recapture if the taxpayer:

(i) Makes a subsequent nonqualified withdrawal from the Hawaii college savings program; or

(ii) Rolls the Hawaii college savings program account into another state's college savings program.

The contribution shall be recaptured by adding the amount previously deducted, not to exceed the amount of the nonqualified withdrawal or rollover, to the taxpayer's adjusted gross income for the tax year in which the nonqualified withdrawal or rollover occurred."

SECTION 3. Section 256-1, Hawaii Revised Statutes, is amended by adding two new definitions to be appropriately inserted and to read as follows:

""Contribution" means:

(1) Any payment directly allocated to a Hawaii college savings program account for the benefit of designated beneficiary, or used to pay administrative fees associated with the account; and

(2) That portion of any rollover amount treated as a contribution under section 529 of the Internal Revenue Code of 1986, as amended, or successor legislation.

"Rollover" means a distribution or transfer from an account that is transferred to or deposited within sixty calendar days of the distribution into an account of the same person for the benefit of the same designated beneficiary or another person who is a member of the family of the designated beneficiary if the transferee account was created under chapter 256 or another college savings program maintained in accordance with section 529 of the Internal Revenue Code of 1986, as amended, or successor legislation."

SECTION 4. Statutory material to be repealed is bracketed and stricken. New statutory material is underscored.

SECTION 5. This Act, upon its approval, shall apply to taxable years beginning after December 31, 2017.

INTRODUCED BY: ______________________

BY REQUEST

SB. NO. 940

JUSTIFICATION SHEET

DEPARTMENT: Budget and Finance

TITLE: A BILL FOR AN ACT RELATING TO THE STATE OF HAWAII SECTION 529 COLLEGE SAVINGS PROGRAM.

PURPOSE: To provide Hawaii taxpayers with an annual maximum deduction from gross taxable income of $5,000 per individual or $10,000 for a married couple filing jointly for contributions made to Hawaii's section 529 college savings program beginning in calendar year 2018.

MEANS: Amend section 235-7, Hawaii Revised Statutes (HRS).

JUSTIFICATION: In 2002, the State of Hawaii established a college savings program pursuant to chapter 256, HRS, and section 529 of the Internal Revenue Code of 1986, as amended. The program was established to assist and encourage families to invest and save funds for future higher education expenses.

In general, an account owner establishes an account for a designated beneficiary, contributes after-tax dollars into the account, and invests the contributions in various investment options offered under the program. These investment options are provided by a program manager that charges account owners a program management fee. The earnings on the contributions grow tax-deferred, and distributions to pay for a beneficiary's qualified higher education expenses are not subject to federal or State income tax (this tax-free treatment was made permanent by the Pension Protection Act of 2006). Currently, the maximum amount that account owners can contribute to an account in the State's section 529 college savings program is $305,000. As of September 30, 2016, there were approximately

6,500 accounts in the program, and $73.1 million in program assets.

The asset size of our State's program is relatively small and the participation rate is low compared to other states' college savings programs. Most states offer some kind of in-state tax deduction or credit for contributions as an incentive for their residents to participate in their college savings programs. To increase our residents' participation in the program and to increase the program's assets so that the State may be able to obtain a lower program management fee in the future, this bill proposes to amend section 235-7, HRS, by providing a state income tax deduction for contributions made by account owners into the program. The proposed deduction from gross taxable income will be a maximum of $5,000 per year for individual taxpayers and $10,000 per year for married couples filing jointly or heads of households.

Impact on the public: This proposal will make Hawaii's program much more attractive to Hawaii taxpayers, and provide an important incentive for Hawaii families to save for future qualified higher education expenses. This will encourage further participation in the program, and may allow the State to secure a lower program management fee in the future as the program assets grow.

Impact on the department and other agencies: An increase in the size of Hawaii's program should provide the Department of Budget and Finance with more leverage to negotiate lower program management fees with program managers and investment product providers. Although this proposal will result in a loss of tax revenues to the State, it is anticipated that the amount of lost tax revenues will be relatively minimal and the benefits to Hawaii taxpayers and beneficiaries of the program to save for college will be greatly enhanced.

Assuming an average deduction of $7,500 per account, it is estimated that the amount of lost tax revenues would be approximately $3,465,000 per year ($7,500 X approximately 5,600 Hawaii account owners = $42,000,000; $42,000,000 X 8.25% Maximum Tax Rate = $3,465,000 potential tax revenue loss).

GENERAL FUNDS:	None.
OTHER FUNDS:	None.
PPBS PROGRAM DESIGNATION:	BUF-115.
OTHER AFFECTED AGENCIES:	Department of Taxation.
EFFECTIVE DATE:	Upon approval, for taxable years beginning calendar year 2018.