SB 203

Department of Legislative Services
Maryland General Assembly
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FISCAL AND POLICY NOTE

Senate Bill 203 (Senators Madaleno and Brinkley)
Budget and Taxation

Family Education Savings Account Act - Subtraction Modification for Contributions

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This bill creates a subtraction modification under the State income tax for contributions made by an individual to a Coverdell Education Savings Account. The amount of the subtraction modification cannot exceed $1,000 for individuals or $2,000 for joint filers.

Individuals who claim a subtraction modification for contributions to the Maryland Prepaid College Trust, Maryland College Investment Plan, or Maryland-Broker Dealer College Investment Plan cannot claim the subtraction modification.

The bill takes effect July 1, 2010, and applies to tax year 2010 and beyond.

Fiscal Summary

State Effect: General fund revenues decrease by $258,400 in FY 2011 due to subtraction modifications claimed against the personal income tax. Future year revenues reflect an increase in future contributions and number of claimants. General fund expenditures increase by $21,300 in FY 2011 for one-time tax form changes and computer programming modifications.

(in dollars)	FY 2011	FY 2012	FY 2013	FY 2014	FY 2015
GF Revenue	($258,400)	($266,200)	($274,200)	($282,400)	($290,900)
GF Expenditure	$21,300	$0	$0	$0	$0
Net Effect	($279,700)	($266,200)	($274,200)	($282,400)	($290,900)

Note:() = decrease; GF = general funds; FF = federal funds; SF = special funds; - = indeterminate effect

Local Effect: Local revenues decrease by $159,800 in FY 2011 and by $179,900 in FY 2015. Expenditures are not affected.

Small Business Effect: Minimal.

Analysis

Current Law /Background:

Federal Income Tax Education Benefits

The federal income tax provides several tax benefits related to education expenses including the American Opportunity, Hope, and Lifetime Learning Credits for qualified higher education expenses; student loan interest deduction; tuition and fees deduction; Coverdell ESA under Section 530 of the Internal Revenue Code; and Qualified Tuition Plans (QTPs) under Section 529 of the IRC.

A Coverdell ESA is a savings account that is set up to pay the qualified education expenses of a designated beneficiary. Generally, any individual (including the beneficiary) whose modified adjusted gross income is less than $110,000 ($220,000 for joint filers) can establish an account. For most individuals modified adjusted gross income will equal federal adjusted gross income. Total contributions for the beneficiary in any tax year cannot exceed $2,000, regardless of how many accounts have been established for the beneficiary. Qualified education expenses are specified expenses related to the beneficiary's enrollment at a qualified elementary, secondary, or higher education school.

Contributions to a Coverdell ESA are not deductible for federal income tax purposes. However, amounts deposited in the account grow tax free and distributions are not taxed if the distributions are used for qualified educations expenses. The taxation of Coverdell ESA contributions and distributions mirror federal tax treatment of Roth IRAs. A qualified tuition program, also called 529 plans, is a program set up to allow an individual to either prepay, or contribute to an account established for paying, a student's qualified education expenses at an eligible education institution. A qualified educational institution includes any college, university, vocational school, or other postsecondary educational institute eligible to participate in a U.S. Department of Education student aid program. There are two types of 529 plans: prepaid tuition plans and college savings plans. All 50 states and the District of Columbia sponsor at least one type of 529 plan. In addition, private colleges and universities are eligible to sponsor a prepaid tuition plan.

Unlike a Coverdell ESA, there are no income restrictions on who can set up or contribute to an account. Individuals can contribute up to the maximum amount necessary to provide for the qualified education expenses of the beneficiary. The federal tax benefits of a 529 plan are generally similar to a Coverdell ESA. Contributions are not tax deductible but amounts deposited in the account grow tax free and distributions (including realized capital gains) are not taxed if the distributions are used for qualified educations expenses.

State Income Tax Treatment of 529 Plans and Coverdell ESAs

Except for State-administered 529 programs, State income tax law conforms to federal tax law related to Coverdell ESA and 529 plan contributions and distributions. Contributions made to a 529 plan or Coverdell ESA are not deductible for State income tax purposes and any distributions for eligible education expenses are not taxable. Individuals who contribute to a State-administered 529 plan can, subject to limitations discussed below, deduct the amount contributed for State income tax purposes. Only contributions made to a State-administered plan qualify for this additional State income tax benefit.

The College Savings Plans of Maryland Board operates two higher education 529 savings programs: the Maryland Prepaid College Trust and the Maryland College Investment Plan. Account holders enroll directly in the programs. Per contract (prepaid trust) and per account (investment plan), a taxpayer may subtract up to $2,500 per year from Maryland taxable income for contributions made to Maryland's college savings plans. Chapter 548 of 2008 also authorized the establishment of a Maryland Broker-Dealer College Investment Plan by the College Savings Plans of Maryland Board. The purpose of the broker-dealer plan is to provide for a college savings plan distributed by brokers and dealers that allows Maryland taxpayers to deduct contributions up to $2,500 per year to the plan from their taxable income for purposes of State and local income taxes beginning with tax year 2008.

Contributions to the Maryland Prepaid College Trust exceeding $2,500 may be carried over to succeeding tax years until the full amount of the advance payment has been used while excess contributions to the investment plans can be carried forward 10 tax years.

More specific information on federal education tax benefits is available in IRS Publication 970 *Tax Benefits for Education* accessible from the IRS web site.

State Revenues: Subtraction modifications can be claimed beginning in tax year 2010. As a result, general fund revenues can decrease by approximately $258,400 in fiscal 2011. This estimate is based on the following facts and assumptions:

- According to the Comptroller's Office, in tax year 2006, approximately 21,400 Maryland taxpayers contributed to a Coverdell ESA. The average contribution was $1,106.

- Future contributions and number of claimants increase by 3% annually.

- One-fifth of Marylanders contributing to a Coverdell ESA do not claim a subtraction modification for Maryland 529 plans.

State Expenditures: The Comptroller's Office reports that it would incur a one-time expenditure increase of $21,300 in fiscal 2011 to add the subtraction modification to the personal income tax form. This amount includes data processing changes to the SMART income tax return processing and imaging systems and systems testing.

Local Revenues: Local income tax revenues decrease by about 3% of the amount of subtraction modifications claimed. Accordingly, local income tax revenues decrease by $159,800 in fiscal 2011, $164,700 in fiscal 2012, $169,600 in fiscal 2013, $174,700 in fiscal 2014, and $179,900 in fiscal 2015.

Additional Information

Prior Introductions: SB 45 / HB 247 of 2009 were not reported out of the Senate Budget and Taxation Committee and House Ways and Means Committee.

Cross File: None.

Information Source(s): Comptroller's Office, Department of Legislative Services

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Analysis by: Robert J. Rehrmann

Direct Inquiries to:
(410) 946-5510
(301) 970-5510