SB 761

Department of Legislative Services

Maryland General Assembly
2020 Session

FISCAL AND POLICY NOTE
First Reader

Senate Bill 761 (Senator Lam)
Budget and Taxation

Income Tax - 529 College Investment Plans - Elementary and Secondary Education Expenses

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This bill prohibits an individual from claiming the subtraction modification for contributions made to the Maryland College Investment Plan and Maryland Broker-Dealer College Investment Plan if the funds are used for elementary or secondary school education expenses. The bill also requires an individual to add back to their income a distribution from the college investment plan or any 529 education plan, if the distribution is used for elementary or secondary school education expenses. The bill also establishes reporting requirements for an individual who receives and the entity that makes distributions from the college investment savings plan and Maryland Broker-Dealer College Investment Plan. The Comptroller must adopt regulations implementing an electronic process for the submission of these statements. **The bill takes effect July 1, 2020, and applies to tax year 2020 and beyond.**

Fiscal Summary

State Effect: General fund revenues may increase by $20.0 million annually beginning in FY 2021. This estimate is based on the current Board of Revenue Estimates (BRE) State revenue forecast as discussed below. General fund expenditures may increase by $377,700 in FY 2021 and by $124,900 in FY 2025 due to implementation costs at the Comptroller's Office.

Local Effect: Under the assumptions above, local income tax revenues may increase by $12.5 million annually beginning in FY 2021. Local expenditures are not affected.

Small Business Effect: None.

Analysis

Bill Summary: Any year in which an individual receives a distribution from the Maryland College Investment Plan and Maryland Broker-Dealer College Investment Plan or a qualified tuition plan (529 plan), the account holder must report to the Comptroller whether the distribution was used for elementary or secondary education expenses.

An entity that makes a distribution under the Maryland College Investment Plan and Maryland Broker-Dealer College Investment Plan must by January 31 of each year submit a statement to the Comptroller and account holder showing (1) the name of the account holder and qualified beneficiary; (2) the date and amount of each distribution; and (3) any other information required by the Comptroller. The entity must electronically submit these statements to the Comptroller.

The Comptroller must adopt regulations establishing (1) the electronic format required for these statements and (2) a process for any entity to request a waiver from this requirement. The Comptroller may waive the electronic format requirement if it is determined that the requirement will result in undue hardship.

Current Law: Under the federal income tax, a distribution from a qualified tuition plan that is used for certain elementary or secondary education expenses is not taxable. The State conforms to the federal tax treatment of these distributions; a qualified distribution is not taxable for State income tax purposes.

For State income tax purposes, an individual may deduct a contribution made for these expenses to the Maryland College Investment Plan and the Maryland Broker-Dealer College Investment Plan as discussed below.

Background:

Federal Tax Benefits and 529 Plans

Qualified tuition plans, also known as 529 plans, are state programs that allow an individual to either prepay or contribute to an account established for paying a student's qualified higher education expenses. Accounts and plans must satisfy the income tax and transfer rules established under Section 529 of the Internal Revenue Code.

The federal Tax Cuts and Jobs Act of 2017 (Public Law 115-97) was signed into law on December 22, 2017, and expands the permissible use of 529 plans by amending "qualified higher education expense" to include expenses for tuition in connection with enrollment or attendance at an elementary or secondary public, private, or religious school. An account holder can withdrawal up to $10,000 in each year for expenses associated with enrollment at these schools. The federal Act applies to distributions made after December 31, 2017.

Maryland 529 Plans and State Tax Benefits

The College Savings Plans of Maryland Board currently operates two qualified tuition plans: the Maryland Prepaid College Trust and the Maryland College Investment Plan. Chapter 548 of 2008 authorized the board to establish a third plan, the Maryland Broker-Dealer College Investment Plan, but the board has yet to do so.

In addition to the federal tax benefits available to 529 plans, the State allows a person to claim a subtraction modification for the advanced amount of tuition payments made to the Maryland Prepaid College Trust or amount contributed to the Maryland College Investment Plan. The subtraction modification claimed by a taxpayer may not exceed $2,500 for each contract purchased (Maryland Prepaid College Trust) or $2,500 per beneficiary (Maryland College Investment Plan). This limitation is increased to $5,000 for married individuals who file jointly if each spouse contributes to a plan.

Any unused amount of the subtraction modification can be carried forward to future tax years until the full amount of the excess is used under the Maryland Prepaid College Trust and up to 10 tax years for contributions to the Maryland College Investment Plan.

An investment plan account holder is not eligible for the subtraction modification for contributions to an investment account in any year in which the account holder receives funds under the State Contribution Program.

The State also allows a person to exclude, to the extent included in federal adjusted gross income, a qualified distribution from the college investment plans. Given these qualified distributions are not currently taxable under the federal income tax, this provision does not generally impact taxpayers.

Nonqualified Distributions

The Comptroller's Office issued Administrative Release 32, which among other items, clarified the treatment of nonqualified distributions. The income (or earnings) portion of a nonqualified distribution is included in federal adjusted gross income, which is used to calculate Maryland taxable income. No further adjustment is necessary by a taxpayer as these earnings will be taxed under the State income tax as well. The taxpayer must make an addition modification that is equal to all of the previous amounts claimed as a subtraction modification for the contributions made to the account.

Proposed Tax Treatment of Elementary and Secondary Education Expenses

Under the federal income tax, contributions are not deductible for federal tax purposes; however, amounts deposited in the account grow tax free and distributions are not subject to federal or state taxes if the distributions are used for the qualified higher education expense of a beneficiary. These tax advantages are similar to the federal tax treatment of Roth IRAs.

As discussed above, in addition to the beneficial State and federal tax treatment of 529 distributions, the State allows an individual, subject to certain limits, to deduct the contribution made to the Maryland College Investment Plan. Accordingly, for State income tax purposes, the contributions can be deductible and any earnings generated in the plan are not taxed either. This is in contrast to the federal tax treatment of most tax advantaged accounts (IRAs, 401ks, or other education savings plans), which provide for either a deduction for account contributions or tax-free distributions, but not both.

Under the bill, an individual will not be able to deduct a contribution for elementary and secondary education expenses and will be taxed on both the contributions and any earnings generated by the investment plan. **Exhibit 1** compares the tax treatment of elementary and secondary education expense contributions and distributions made to a college investment plan under current federal and state law and as proposed by the bill.

Exhibit 1
College Investment Plan Elementary and Secondary Education Expenses
Federal and State Taxation
Current Law and Proposed

	Contributions	Distributions
Current Law		
Federal Law	Non-deductible	Non-taxable
State Law	Deductible	Non-taxable
Proposed		
Federal Law	Non-deductible	Non-taxable
State Law	Non-deductible	Taxable

State Revenues: Beginning in tax year 2020, the bill will prohibit an individual from claiming the subtraction modification for contributions made to the Maryland College

Investment Plan if the funds are used for elementary or secondary school education expenses. The bill also requires an individual to add back to their income the amount of money distributed from the plan or any 529 education plan if the distribution is used for elementary or secondary school education expenses.

In its 60-day report detailing the impact of the federal Tax Cuts and Jobs Act of 2017, the Comptroller's Office estimated that the Act's provision that allows individuals to make 529 plan contributions for elementary and secondary school education expenses will decrease general fund revenues by $20.0 million annually. This estimate reflects additional State subtraction modifications claimed for the contributions and is incorporated in the December 2019 BRE general fund forecast.

The bill will also tax a distribution that is made from a 529 plan and is used for elementary and secondary school education expenses. Accordingly, additional revenue gains may be generated from this provision to the extent individuals continue to contribute to the plans for these purposes.

The bill's provisions related to the Maryland Broker-Dealer College Investment Plan will not impact State revenues as the plan has not been implemented.

State Expenditures: The Comptroller's Office advises that it will incur additional costs beginning in fiscal 2021 as a result of hiring two revenue examiners and incurring programming expenses. As a result, general fund expenditures increase by $377,698 in fiscal 2021, which reflects a July 1, 2020 hiring date. It includes salaries, fringe benefits, one-time start-up costs, and ongoing operating expenses.

Positions	2
Salary and Fringe Benefits	$116,648
Operating Expenses	11,050
Programming Expenditures	250,000
Total FY 2021 Expenditures	**$377,698**

Future year expenditures increase by $114,100 in fiscal 2022 and by $124,900 in fiscal 2025. This estimate reflects full salaries with annual increases and employee turnover as well as ongoing operating expenses.

Local Revenues: Local revenues will increase due to a reduction in subtraction modifications claimed and from individuals adding back college investment plan distributions as required by the bill. Based on the assumptions above, local income tax revenues may increase by $12.5 million annually beginning in fiscal 2021.

Additional Information

Prior Introductions: None.

Designated Cross File: HB 1066 (Delegate Ebersole, *et al.*) - Ways and Means.

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

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