

NORTH CAROLINA GENERAL ASSEMBLY

LEGISLATIVE FISCAL NOTE

BILL NUMBER: Senate Bill 923 (First Edition)

SHORT TITLE: College Vision Tax Deduction

SPONSOR(S): Senator Rand

FISCAL IMPACT					
	Yes (X)	No ()	No Estimate Available ()		
	(\$million)				
	<u>FY 2003-04</u>	<u>FY 2004-05</u>	<u>FY 2005-06</u>	<u>FY 2006-07</u>	<u>FY 2007-08</u>
REVENUES					
General Fund	0	(\$828,000)	(\$952,000)	(\$1,095,000)	(\$1,259,000)
EXPENDITURES					
POSITIONS: (cumulative)					
PRINCIPAL DEPARTMENT(S) & PROGRAM(S) AFFECTED: Department of Revenue; North Carolina State Education Assistance Authority					
EFFECTIVE DATE: This act becomes effective for taxable years beginning on or after January 1, 2004.					

BILL SUMMARY: The bill provides a state income deduction for contributions to the Parental Savings Trust Fund managed by the North Carolina State Education Assistance Authority. The deduction is equal to \$1,000 per beneficiary per year for a married couple filing jointly and up to \$500 per beneficiary per year for other taxpayers.

BACKGROUND: In 1996, Congress approved state administered “qualified tuition programs” that are now commonly known as “529 plans” after section 529 of the Internal Revenue Code. Investment earnings on contributions to a 529 plan are free of federal individual income tax until withdrawal and remain income tax free if used for qualified education purposes. In 1997, North Carolina granted a state individual income tax exemption for investment income earned in a Parental Savings Trust Fund and a state income tax deduction for earnings on money withdrawn from such a fund to pay for eligible college expenses. (SL 1997, ch.328) This state income tax deduction was repealed in 2002 when the state conformed to federal tax changes in the Economic Growth and Tax Relief Reconciliation Act of 2001. (Conforming to the federal code meant the withdrawn funds were tax exempt at the state level too.)

The North Carolina State Education Assistance Authority launched the state's 529 plan, the College Vision Fund, in June 1998. The fund invested contributions with the State Treasurer in low yield, fixed income instruments such as government bonds and U.S. treasury bills. This program was renamed the National College Savings Program in 2001 and expanded to offer additional investment options. Unlike 24 states and the District of Columbia, North Carolina does not allow a tax deduction for contributions to a 529 plan.

ASSUMPTIONS AND METHODOLOGY: The State Education Assistance Authority provided data on the amount invested in its 529 plan, the National College Savings Program, between May 1, 2002, and April 30, 2003. In this period, 6,979 taxpayers invested \$55.56 million on behalf of 11,110 beneficiaries. To estimate the revenue loss to the state General Fund from the proposed state income tax deduction for 529 plan contributions, this fiscal note assumes all contributors have a state individual income tax liability. Since no information is known on the marital status of the taxpayer, this fiscal note assumes all taxpayers are married filing jointly and eligible for up to \$1,000 per beneficiary. For contributions below \$1,000, the actual amount contributed was assumed to be at the midpoint of the range. A 7% marginal tax bracket is used for most contributors with the exception of the lowest (6%) and the two highest contributor levels (7.75%).

<u>Annual Contribution</u>	<u>Number of Beneficiaries 5/1/02 - 4/30/03</u>	<u>Assumed Tax Deduction</u>	<u>Total Tax Deduction</u>	<u>Assumed Tax Brackets</u>	<u>General Fund Loss</u>
0 - \$99	1,306	\$50	\$65,300	6.00%	(\$3,918)
\$100 - \$199	462	\$150	\$69,300	7.00%	(\$4,851)
\$200 - \$299	332	\$250	\$83,000	7.00%	(\$5,810)
\$300 - \$399	359	\$350	\$125,650	7.00%	(\$8,796)
\$400 - \$499	376	\$450	\$169,200	7.00%	(\$11,844)
\$500 - \$999	1,677	\$750	\$1,257,750	7.00%	(\$88,043)
\$1000 - \$1499	1,169	\$1,000	\$1,169,000	7.00%	(\$81,830)
\$1500 - \$2000	744	\$1,000	\$744,000	7.75%	(\$57,660)
over \$2000	<u>4,685</u>	\$1,000	<u>\$4,685,000</u>	7.75%	<u>(\$363,088)</u>
	11,110		\$8,368,200		(\$625,839)

Based on the chart above, if participants in the National College Savings Program continue contributing at the same rate as was experienced in 2002/2003, then the state General Fund loss would be approximately \$625,000 a year. However, significant growth is expected in these savings plans. The Wall Street Journal (May 9, 2002 WJR.com) and other national newspapers quote a report from Boston's Cerulli Associates that estimates national 529 plan assets will grow from \$18 billion in 2002 to \$51 billion in 2006. This 46% annual growth rate includes both investment earnings and new contributions. Whitney Dow, Director of Education Savings Research with Financial Research Corporation, estimates 21% annual growth in 529 plan sales over the next five years. In the 2001 and 2003, Tax Expenditure Reports prepared by Ohio's Department of Taxation, the state's estimated general fund revenue loss from an income tax deduction for college savings programs is anticipated to increase from \$2.7 million in 2002 to \$4.5 million in 2005. This is an increase of 18.5% a year in the four-year period.

This fiscal note assumes a 15% growth rate in 529 plan participants. According to College Savings Plan Network.org, North Carolina's 529 plan's \$64.5 million in assets in 2002 ranked 36th among 50 state plans. North Carolina's 529 plan was initially hampered by limited investment options, but may continue to be restrained by caps on broker fees. North Carolina pays brokers 4% of the contribution for directing clients to the state's 529 plan while other states, such as Virginia, pay up to 6% for referrals. This note assumes the broker fee cap will keep North Carolina's sales growth below the 21% national estimate.

Applying the 15% growth rate to the number of participants in the contribution brackets shown in the chart above, the following estimates of General Fund loss are derived.

Annual Contribution	03-04	04-05	05-06	06-07	07-08
0 - \$99	\$4,506	\$5,182	\$5,959	\$6,853	\$7,880
\$100 - \$199	\$5,579	\$6,415	\$7,378	\$8,484	\$9,757
\$200 - \$299	\$6,682	\$7,684	\$8,836	\$10,162	\$11,686
\$300 - \$399	\$10,115	\$11,632	\$13,377	\$15,383	\$17,691
\$400 - \$499	\$13,621	\$15,664	\$18,013	\$20,715	\$23,823
\$500 - \$999	\$101,249	\$116,436	\$133,902	\$153,987	\$177,085
\$1000 - \$1499	\$94,105	\$108,220	\$124,453	\$143,121	\$164,589
\$1500 - \$2000	\$66,309	\$76,255	\$87,694	\$100,848	\$115,975
over \$2000	\$417,551	\$480,183	\$552,211	\$635,042	\$730,299
	\$719,714	\$827,671	\$951,822	\$1,094,595	\$1,258,785

SOURCES OF DATA: North Carolina State Education Assistance Authority; College Savings Plan Network.org; Ohio Department of Taxation Tax Expenditure Report; Financial Research Corporation

TECHNICAL CONSIDERATIONS: The short and long titles may need to be changed. The titles refer to a College Vision or College Vision Fund. The state's 529 plan is referenced as the Parental Savings Trust Fund in GS 116-209.25 and as the National College Savings Program in promotions by the North Carolina State Education Assistance Authority.

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