

FEB 23 2005
WAYS & MEANS CALENDAR

HOUSE FILE 400
BY COMMITTEE ON WAYS AND MEANS

(SUCCESSOR TO HF 25)

(COMPANION TO SF 11 BY BRUNKHORST)

Passed House, Date _____ Passed Senate, Date _____
Vote: Ayes _____ Nays _____ Vote: Ayes _____ Nays _____
Approved _____

A BILL FOR

1 An Act providing for an individual income tax deduction for
2 contributions made to a qualified tuition program established
3 by certain educational institutions and including effective
4 and retroactive applicability date provisions.

5 BE IT ENACTED BY THE GENERAL ASSEMBLY OF THE STATE OF IOWA:

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HF 400

1 Section 1. Section 422.7, Code 2005, is amended by adding
2 the following new subsection:

3 NEW SUBSECTION. 32A. a. Subtract contributions made by
4 the taxpayer as a participant in a qualified tuition program,
5 as defined in section 529(b) of the Internal Revenue Code,
6 established by one or more eligible educational institutions.
7 The maximum amount that may be subtracted under this paragraph
8 equals the maximum amount that is deductible under section
9 12D.3, subsection 1, paragraph "a", for contributions made to
10 the Iowa educational savings plan trust minus any amount
11 subtracted pursuant to subsection 32, paragraph "a", of this
12 section.

13 b. Add the amount of cash refunds or withdrawals refunded
14 to the taxpayer as a participant in a qualified tuition
15 program that is not used to satisfy qualified higher education
16 expenses, as defined in section 529(e) of the Internal Revenue
17 Code, to the extent previously deducted under paragraph "a".

18 Sec. 2. EFFECTIVE AND RETROACTIVE DATE. This Act, being
19 deemed of immediate importance, takes effect upon enactment
20 and applies retroactively to January 1, 2005, for tax years
21 beginning on or after that date.

22 EXPLANATION

23 This bill allows for an individual income tax deduction for
24 contributions made to a qualified tuition program established
25 by one or more educational institutions. The program is the
26 counterpart to the Iowa educational savings plan trust (state
27 program) and allows a taxpayer to make contributions to a
28 trust set up in the name of a designated beneficiary to pay
29 the costs associated with higher education. The amount that
30 may be deducted is the maximum amount that may be deducted for
31 contributions to the state program (\$2,000, to be adjusted for
32 inflation) less any amount that has been deducted for the tax
33 year for contributions to the state program.

34 The bill also provides that any refunds or withdrawals made
35 which the taxpayer receives and which are not used for

1 qualified tuition costs are to be included in income to the
2 extent previously deducted.

3 The bill takes effect upon enactment and applies
4 retroactively to January 1, 2005, for tax years beginning on
5 or after that date.

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Fiscal Services Division
Legislative Services Agency
Fiscal Note

HF 400 - Higher Education Plan Income Tax Deductions (LSB 1507 HV)
Analyst: Jeff Robinson (Phone: (515) 281-4614) (jeff.robinson@legis.state.ia.us)
Fiscal Note Version – New
Requested by Representative Jodi Tymeson

Description

House File 400 allows Iowa income tax deductions for contributions made to 529 college savings plans administered by any eligible educational institution. The tax law change applies retroactively to tax years beginning on or after January 1, 2005.

Background

The federal government has established tax-benefited college savings options referred to collectively as "529 plans." The federal government allows money in 529 accounts to grow tax free, and to be withdrawn tax free when used for qualified higher education expenses. The federal tax code does not provide for a tax deduction for contributions to a 529 account.

Iowa currently allows a State income tax deduction for contributions to the college savings plan administered by the State Treasurer (College Savings Iowa). Contributions up to a set annual limit may be deducted from the contributor's Iowa taxable income. Since contributions are deductible at the State level and not the federal level, the contributions reduce state tax liability and raise federal tax liability (for federal itemizers). Due to federal deductibility, this interaction further decreases state tax liability.

House File 400 expands the Iowa income tax deduction to contributions made to any 529 plan established by an "eligible educational institution." There is currently available an Independent 529 Plan operated by a consortium of more than 240 private colleges & universities throughout the United States. Eleven Iowa institutions are participating in the Plan. The Independent 529 Plan allows the contributor to invest in "pre-paid" tuition. Contributions to the Independent 529 account are used to purchase "certificates" redeemable for future tuition. When a child attends a participating private institution, the pre-paid account provides a specified number of college credit hours.

A pre-paid tuition plan is regarded as an asset of the student, where other 529 plan assets are regarded as an asset of the contributor. As an asset of the student, pre-paid tuition plans reduce the student's financial need, and therefore, any need-based financial assistance available. Therefore, pre-paid tuition plans are less valuable to students who are eligible for financial aid at private institutions.

Assumptions

1. For the foreseeable future, only the Independent 529 Plan and College Savings Plan Iowa will operate in Iowa.
2. A total of 3,000 accounts will be established with the Independent 529 Plan in tax year 2005, and that number will grow to 30,000 by tax year 2012. Of those accounts, 70.0% will be accounts that would have utilized the State's current 529 plan (College Savings Iowa) if the Independent 529 Plan was not available. Accounts that would have otherwise utilized College Savings Iowa do not create any additional tax deductions.
3. Since pre-paid tuition plans are regarded as an asset of the student, pre-paid plans will likely be utilized in high income families where the possibility of need-based financial

assistance is low. Therefore, the average federal and state marginal tax rate will be high (state average 8.5%, federal average 30.0%).

4. The average total annual contribution to each account will be \$1,800 in tax year 2005 and will grow 3.2% annually. Due to the interaction between state and federal tax deductions, the true impact of the state-only tax deduction is equal to 102.55% of the allowed deduction (assumes the average marginal tax rates of assumption 3).
5. Tax year 2005 deductions will not decrease state tax collections until FY 2006.

Fiscal Impact

The tax deduction created in House File 400 will reduce net General Fund income tax receipts by:

- FY 2006: \$0.4 million
- FY 2007: \$0.6 million
- FY 2008: \$0.9 million
- FY 2009: \$1.3 million
- FY 2010: \$1.8 million
- FY 2011: \$2.3 million
- FY 2012: \$2.9 million

After FY 2012, the annual impact will grow by 3.2%.

Sources

Department of Revenue
State Treasurer
Legislative Services Agency

/s/ Holly M. Lyons

March 1, 2005

The fiscal note and correctional impact statement for this bill was prepared pursuant to Joint Rule 17 and pursuant to Section 2.56, Code of Iowa. Data used in developing this fiscal note and correctional impact statement are available from the Fiscal Services Division, Legislative Services Agency to members of the Legislature upon request.
