Legislative Fiscal Bureau

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September 21, 2005

TO: Members
Joint Committee on Finance

FROM: Bob Lang, Director

SUBJECT: Senate Bill 336: Individual Income Tax Credit for Certain Contributions to College Savings Programs

Senate Bill 336 would provide a nonrefundable credit against the individual income tax based on certain amounts paid into an account in a Wisconsin college savings program to include such amounts paid into any college savings program. SB 336 was introduced on September 16, 2005, and referred to the Joint Committee on Finance.

CURRENT LAW

Federal Law

As provided under federal law, a qualified tuition program (QTP), also known as a section 529 plan (in reference to the section of the Internal Revenue Code authorizing such plans), is a program that allows individuals to either purchase pre-paid tuition units or to contribute to a college savings account established for paying a student's qualified education expenses at an eligible educational institution. A QTP can be established and maintained by a state, or an agency or instrumentality of a state, and by an eligible educational intuition. For programs satisfying the federal QTP requirements, federal law has provided an individual income tax exemption for earnings in and distributions from (but not contributions to) QTPs established by states since tax year 2002. Effective with tax year 2004, the federal exemption was extended to earnings in and distributions from QTPs offered by eligible private institutions in addition to state-sponsored plans.

State Law

Current law authorizes two types of Wisconsin section 529 programs. The first program is a pre-pay plan, under which an individual may purchase tuition units for a designated beneficiary. This program, sometimes referred to as EdVest I, was started in 1997 and is administered by the State Treasurer's office with investments managed by the State of Wisconsin Investment Board.

The second type of section 529 plan authorized by the state is the college savings account program, under which individuals make payments into a college savings account approved by the 11-member College Savings Program Board on behalf of a designated beneficiary (rather than purchasing tuition units). The College Savings Program Board has approved college savings accounts offered through EdVest, referred to as EdVest II, as well as through Tomorrow's Scholar, which is managed by American Express. Section 529 college savings accounts were first offered by the state in May, 2001.

State statutes continue to authorize both the tuition unit type of section 529 programs (offered as EdVest I), and the college savings account type of section 529 programs (offered as EdVest II and Tomorrow's Scholar). However, as a result of the greater complexity of the tuition unit option and following a decline in public interest in purchasing tuition units, EdVest I was closed to new investments, effective December 20, 2002.

State tax law conforms to the federal provisions providing an exemption from income for earnings in, and qualified distributions from, state approved section 529 plans. In addition, for state tax purposes, donors have been permitted to deduct up to $3,000 in amounts paid into a Wisconsin section 529 plan if the beneficiary is the purchaser, the purchaser's spouse (for a married couple filing a joint tax return), or the purchaser's dependent child. Under 2001 Wisconsin Act 109, the deduction for amounts paid into Wisconsin section 529 accounts was extended to grandparents of a beneficiary, effective with tax year 2002. Under 2003 Wisconsin Act 289, effective January 1, 2004, the deduction was again expanded, this time to include amounts paid by great-grandparents, aunts, and uncles of account beneficiaries. The annual deduction for amounts paid into one or more state-approved section 529 account for a specific beneficiary is limited to $3,000 per claimant. A married couple filing a joint return is considered one claimant.

SUMMARY OF BILL

SB 336 would provide a nonrefundable credit against the individual income tax for certain amounts contributed to a section 529 plan. As with the current law deductions for contributions to Wisconsin section 529 plans, a taxpayer would be eligible for the proposed credit if the beneficiary were the purchaser, the purchaser's spouse (for a married couple filing a joint tax return), or the purchaser's child or if the purchaser were a grandparent, great-grandparent, aunt, or uncle of the account beneficiary. The credit would be limited to the claimant's marginal tax rate times the amount contributed, up to a maximum contribution level of $3,000 per beneficiary (up to $1,500 for married persons filing separate returns). A married couple filing a joint return would be considered to be one claimant. The credit would be prorated for nonresidents and part-year residents based on the ratio of the claimant's Wisconsin adjusted gross income (AGI) to federal AGI.

Unlike the current deductions, which are limited to contributions to Wisconsin section 529 plans, the proposed credit would apply with respect to any section 529 plan, including such a plan offered through EdVest or Tomorrow's Scholar, through another state, or through an eligible institution. However, the credit could not be claimed by a taxpayer also claiming a deduction for EdVest contributions.

These provisions would first apply to taxable years beginning on January 1, 2006.

FISCAL EFFECT

Based on information provided by the College Savings Plan Network, other states' college savings plan programs, and Wisconsin's EdVest program, it is estimated that the proposal would reduce Wisconsin individual income tax collections by $7.0 million in 2006-07.

Historical data provided by the College Savings Plan Network reveals strong annual growth in the number of section 529 accounts; a report dated June 30, 2005, indicated that there were 7.5 million accounts in state-sponsored section 529 plans, which was approximately 10% more than the 6.8 million accounts reported on June 30, 2004. If strong growth in the number of such plans continues, as is expected, then the fiscal effect of SB 336 in subsequent years would be correspondingly higher than the estimate provided for 2006-07.

It should be noted that the estimated gross balance in the state's general fund for 2006-07 is $70.4 million. If SB 336 were to be enacted, the estimated balance would be reduced to $63.4 million.

Section 20.003(4) of the statutes indicates that "no bill directly or indirectly affecting general purpose revenues…may be enacted by the Legislature if the bill would cause the estimated general fund balance on June 30 of any fiscal year…to be an amount equal to less than…for fiscal year 2006-07, $65,000,000."

In addition, s. 20.003(4m) of the statutes indicates that "no bill may be adopted by the Legislature if the bill would cause in any fiscal year total expenditures…to exceed taxes and departmental revenues…" This provision applies to the general fund. Adoption by the Legislature of SB 336 would cause general fund expenditures to exceed taxes and departmental revenues by $1.9 million in 2006-07.

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