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FISCAL IMPACT REPORT

ORIGINAL DATE 2/1/18

SPONSOR Kernan LAST UPDATED _____ HB _____

SHORT TITLE Conform 529 Programs to IRS Code SB 209

ANALYST Clark

REVENUE (dollars in thousands)

Estimated Revenue*					Recurring or Nonrecurring	Fund Affected
FY18	FY19	FY20	FY21	FY22		
Minimal	Up to (\$10,400.0)	Up to (\$10,400.0)	Up to (\$10,400.0)	Up to (\$10,400.0)	Recurring	General Fund

Parenthesis () indicate revenue decreases

*This represents the upper limit of the possible impact; the actual impact is likely to be somewhat less but is impossible to properly estimate at this point because it depends on how taxpayers change their behavior.

ESTIMATED ADDITIONAL OPERATING BUDGET IMPACT (dollars in thousands)

	FY18	FY19	FY20	3 Year Total Cost	Recurring or Nonrecurring	Fund Affected
Total	See Fiscal Implications					

Parenthesis () indicate expenditure decreases

Duplicates HB240
Relates to SB210, HB241

SOURCES OF INFORMATION

LFC Files

Responses Received From

Taxation and Revenue Department (TRD)
Higher Education Department (HED)

SUMMARY

Synopsis of Bill

Senate Bill 209 conforms the existing state income tax deduction for contributions to the 529 program for long-term college savings to account for changes in federal statute as a result of the Tax Cuts and Jobs Act (federal tax reform). The two key changes in federal law are: (1) up to

\$10 thousand can be distributed annually from a 529 account toward paying tuition costs for private schools grades K-12, and (2) up to \$15 thousand can be rolled over annually from a 529 plan to an Achieving a Better Life Experience (ABLE) account belonging to the beneficiary of the 529 account.

This bill aligns state tax law with the updated federal code by establishing the ability of New Mexico taxpayers to deduct from income up to \$10 thousand per year contributed to a 529 account for tuition at a K-12 educational institution and establishing the ability to roll over up to \$15 thousand per year from a 529 account to an ABLE account for a disabled beneficiary.

There is no effective date of this bill. It is assumed that the effective date is 90 days after this session ends.

FISCAL IMPLICATIONS

The Taxation and Revenue Department (TRD) reports approximately 4,200 taxpayers claim this deduction annually; the current annual expenditure is approximately \$1.1 million per year. Conforming to federal language will broaden the number of qualifying institutions, potentially increasing the number of taxpayers who might seek the deduction. TRD estimated the increase could be in the 50 percent range.

LFC analysis shows a negative impact to the general fund of up to \$10.4 million if this deduction were taken for funds used to pay private school tuition for every student in the state attending private school. It is very unlikely this would happen for every student, but this shows the magnitude of the possible impact at the upper end, and the deduction could prove to be a very strong incentive for taxpayers to lower the effective cost of sending children to private schools.

Private School Review reports there are 213 private schools in New Mexico serving nearly 25 thousand students, and the average tuition is \$8,510 per year. This organization's data appears to be corroborated by other available estimates of tuition costs in the state. At the far end of the possible scale of the impact, this could represent a possible total of more than \$200 million of income tax deductions. Assuming a 4.9 percent income tax bracket, this could reduce general fund revenues by up to \$10.4 million annually.

This bill may be counter to the LFC tax policy principle of adequacy, efficiency, and equity. Due to the increasing cost of tax expenditures, revenues may be insufficient to cover growing recurring appropriations.

Estimating the cost of tax expenditures is difficult. Confidentiality requirements surrounding certain taxpayer information create uncertainty, and analysts must frequently interpret third-party data sources. The statutory criteria for a tax expenditure may be ambiguous, further complicating the initial cost estimate of the expenditure's fiscal impact. Once a tax expenditure has been approved, information constraints continue to create challenges in tracking the real costs (and benefits) of tax expenditures.

SIGNIFICANT ISSUES

By conforming to the federal tax code changes, this bill makes the significant policy decision to allow the state to subsidize tuition payments for private schools.

The Higher Education Department (HED) provided the following analysis.

The proposed legislation extends the recapture provision for transfers made from 529 accounts to ABLE accounts not qualified under NMSA 1978 6-8A-2.K. It also allows a deduction for contributions made to a 529 account for the amount of payments made on behalf of any one beneficiary that shall not exceed in the aggregate the cost of attendance at an educational institution eligible to receive payment for qualified higher education expenses in accordance with Section 529 of the Internal Revenue Code.

Current New Mexico tax law allows a state tax deduction for contributions to the New Mexico 529 program if the contributions are used to pay for the cost of attendance at an “institution of higher education.” The bill seeks to permit a deduction for the cost of attendance at "an educational institution eligible to receive payment for qualified higher education expenses in accordance with Section 529 of the Internal Revenue Code." Section 529 of the Internal Revenue Code expanded qualified higher education expenses under federal law to include up to \$10 thousand for the cost of tuition at K-12 institutions.

Contributions to the New Mexico 529 program are deductible from income for New Mexico tax purposes. The federal legislation permits a rollover up to \$15 thousand per year from a 529 account to an ABLE account for a disabled beneficiary. The proposed amendment to New Mexico tax law seeks to extend the recapture provision for rollovers made from 529 accounts to ABLE accounts not qualified under NMSA 1978 6-8A-2.K.

Relatively few ABLE accounts have been opened in the New Mexico ABLE program to date. According to the State Treasurer's Office, there are fewer than 100 ABLE accounts in New Mexico. Because there are so few ABLE accounts, the current fiscal impact of the potential tax deduction created by the ability to deduct contributions to a 529 account prior to rolling the amount over into an ABLE account would likely be minimal but the fiscal impact is unknown at this time.

ADMINISTRATIVE IMPLICATIONS

LFC staff estimate the use of this deduction for the newly added purpose of funding K-12 private education could cause a moderate administrative impact for the Taxation and Revenue Department (TRD) due to audit and compliance concerns.

CONFLICT, DUPLICATION, COMPANIONSHIP, RELATIONSHIP

Duplicates HB240 and relates to SB210 and HB241, which amend other sections of statute related to the 529 program.

ALTERNATIVES

Legislation could consider adding a cap to each taxpayer for the amount that may be deducted from income taxes for 529 program contributions. This could limit the negative general fund impact.

Does the bill meet the Legislative Finance Committee tax policy principles?

1. **Adequacy:** Revenue should be adequate to fund needed government services.
2. **Efficiency:** Tax base should be as broad as possible and avoid excess reliance on one tax.
3. **Equity:** Different taxpayers should be treated fairly.
4. **Simplicity:** Collection should be simple and easily understood.
5. **Accountability:** Preferences should be easy to monitor and evaluate.

Does the bill meet the Legislative Finance Committee tax expenditure policy principles?

1. **Vetted:** The proposed new or expanded tax expenditure was vetted through interim legislative committees, such as LFC and the Revenue Stabilization and Tax Policy Committee, to review fiscal, legal, and general policy parameters.
2. **Targeted:** The tax expenditure has a clearly stated purpose, long-term goals, and measurable annual targets designed to mark progress toward the goals.
3. **Transparent:** The tax expenditure requires at least annual reporting by the recipients, the Taxation and Revenue Department, and other relevant agencies.
4. **Accountable:** The required reporting allows for analysis by members of the public to determine progress toward annual targets and determination of effectiveness and efficiency. The tax expenditure is set to expire unless legislative action is taken to review the tax expenditure and extend the expiration date.
5. **Effective:** The tax expenditure fulfills the stated purpose. If the tax expenditure is designed to alter behavior – for example, economic development incentives intended to increase economic growth – there are indicators the recipients would not have performed the desired actions “but for” the existence of the tax expenditure.
6. **Efficient:** The tax expenditure is the most cost-effective way to achieve the desired results.