FISCAL IMPACT REPORT

		ORIGINAL DATE	2/01/18		
SPONSOR	Kernan	**LAST UPDATED**	2/02/18	**HB**	
SHORT TITLE	Conform Education Trust Act to Federal Change			**SB**	210
				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

****The impact is a result of references in existing statute for the income tax deduction for 529 program contributions interacting with the changes to definitions in this bill. It appears this impact is unintentional because this bill does not make any changes directly to tax statute. The bill could be amended to remove this impact.***

*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 HB241
Relates to SB209, HB240

SOURCES OF INFORMATION
LFC Files

Responses Received From
Higher Education Department (HED)

SUMMARY

Synopsis of Bill

Senate Bill 210 conforms the existing language in the New Mexico Education Trust Act with changes in federal statute as a result of the Tax Cuts and Jobs Act (federal tax reform) that made changes to the 529 program for long-term college savings. 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 (under the updated definition of "higher education"), 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.

The bill aligns the New Mexico Education Trust Act with the newly changed federal law by defining an "eligible educational institution" as an educational institution eligible to receive payment for qualified higher education expenses in accordance with Section 529 of the Internal Revenue Code and defining "qualified higher education expenses" as those expenses allowed under Section 529 of the Internal Revenue Code.

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 existing state income tax deduction for 529 program contributions references an "applicable institution of higher education, as determined by the Education Trust Board." This bill strikes the definition of "institution of higher education" from the Education Trust Act and inserts two new definitions that include the phrasing "higher education" that explicitly conform to the federal code for the 529 program, which now includes K-12 private school education as part of that definition. With the existing definition (specifying a higher education institution exclusively refers to post-secondary schools) stricken by this bill, existing statute for the state tax deduction can reasonably be interpreted to mean K-12 institutions and expenses would qualify for the deduction just as they would qualify for the 529 program itself through this bill.

As a result, this bill (seemingly unintentionally) 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. This may have been an unintentional impact of this bill, but given the changes to definitions, the Education Trust Board and the Taxation and Revenue Department would likely be unable to prevent someone from claiming the deduction for contributions intended for K-12 tuition.

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

Through the previously mentioned existing statutory references and the updated definitions in the bill, 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 federal government regularly revises Section 529 of the Internal Revenue Code to interpret legislative and executive actions regarding taxation. For example, qualified higher education expenses now include the purchase of computers. The proposed legislation seeks to broaden some terminology in the Education Trust Act to allow New Mexico's 529 program to align with federal 529 program changes and criteria.
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> Section 21-21K-3.B NMSA 1978 of the Education Trust Act mandates that the Education Trust Board (ETB) "shall develop and administer the college savings program in a manner that allows account owners and beneficiaries to obtain and maintain federal income tax benefits or treatment provided by the Internal Revenue Code for qualified state tuition programs." ETB manages New Mexico's 529 program and associated accounts. Currently, 22 thousand New Mexico beneficiaries have accounts through ETB, with over $425 million saved for education expenses. The average account size is about $19 thousand.
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> Due to New Mexico's small population, ETB's governing board authorizes the marketing of New Mexico's 529 program nationwide. The fees generated by the interstate program allow New Mexico to maintain one of the lowest cost programs in the country for its citizens. For example, Idaho, a western state with geography and demographics similar to New Mexico, does not sell its 529 program nationwide. The account fees for the Idaho 529 program are more than three times those of the New Mexico 529 program, possibly as a result of a smaller number of participants.
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> Nearly all states offer 529 savings programs. A significant number of the states already have 529 legislation that accommodates the new federal law. Others are considering such changes. The New Mexico 529 program will likely lose a competitive advantage to other

programs if it does not adapt to the new legislation because the Education Trust Act will not specifically accommodate changes to the federal 529 program.

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 due to audit and compliance concerns.

CONFLICT, DUPLICATION, COMPANIONSHIP, RELATIONSHIP

Duplicates HB241 and relates to SB209 and HB240, which amend sections of Mew Mexico's tax statutes related to the 529 program.

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.

JC/sb