DEPARTMENT OF TAXATION
2005 Fiscal Impact Statement

1. Patron J. Brandon Bell, II

2. Bill Number SB 769

House of Origin:
X **Introduced**
____ **Substitute**
____ **Engrossed**

Second House:
____ **In Committee**
____ **Substitute**
____ **Enrolled**

3. Committee Senate Finance

4. Title Individual Income Tax: Deduction for the Purchase of Internal Revenue Code § 529 Qualified Tuition Programs

5. Summary/Purpose:

This bill would allow an income tax deduction for taxpayers who purchase or contribute to a qualified tuition program as defined under § 529 of the Internal Revenue Code other than the Virginia College Savings Plan. This deduction would have a limit of $2,000 per designated beneficiary for any taxable year. If the payment or contribution exceeds $2,000, taxpayers would be allowed to carry over the excess to future taxable years. Taxpayers who have attained the age of 70 would not be subject to the $2,000 per taxable year limitation.

This bill would be effective for taxable years beginning on and after January 1, 2005.

6. Fiscal Impact Estimates are: Preliminary. (See Line 8.)

6a. Expenditure Impact:

Fiscal Year	*Dollars*	*Positions*	*Fund*
2004-05	$0	0	GF
2005-06	$33,200	0	GF
2006-07	$0	0	GF
2007-08	$0	0	GF
2008-09	$0	0	GF
2009-10	$0	0	GF
2010-11	$0	0	GF

7. Budget amendment necessary: Yes.
ITEM(S): 284 and 286, Department of Taxation

8. Fiscal implications:

The Department of Taxation is in the final stages of preparing for an August changeover to an entirely new system developed over many years through a public-private partnership. Legislative changes that become effective before the new system is in place must be made to both the old and new systems. However, the Department must “freeze” both systems for several months while its existing records and other data are converted to the new system, and will not be able to resume system modifications until the new system is stable. This freeze is required both by the physical requirements of a major system upgrade and the fact that all personnel capable of modifying either system will be fully committed to the changeover.

The Department would incur costs of $33,200 for FY 2006 to implement this bill, including necessary systems changes. The Department believes that there will be sufficient time available to make the necessary systems changes required by this bill without affecting the system changeover. However, if numerous changes must be implemented within the same time frame the Department may not be able to accomplish all of the modifications without additional resources or the ability to delay the effective date of some of the changes.

The revenue impact of this bill is unknown, but it is likely that there would be some loss of revenue. It is not known how many taxpayers have chosen to invest in the Section 529 plans of other states or public or private educational institutions. In addition, the savings trust account portion of the Virginia plan, which can be used for out-of-state colleges, has experienced the most growth. Thus, it is unknown how many taxpayers would change to other Section 529 plans.

9. Specific agency or political subdivisions affected:

Department of Taxation
Virginia College Savings Plan

10. Technical amendment necessary: Yes.

In order to prevent taxpayers under the age of 70 from claiming a deduction in excess of $2,000 when carrying over the deduction, the following technical amendment is suggested:

Page 5, Line 261 after deducted.
Insert: However, except as provided in the exception below, in no event shall the amount deducted in any taxable year exceed $2,000 per designated beneficiary.

11. Other comments:

General

Section 529 plans are either prepaid tuition programs or savings account plans that allow people to save for future college expenses. These plans are offered by states or by public or private educational institutions and have two significant federal income tax benefits. First, the growth of the account is tax-deferred. In addition, the distributions from these accounts are tax-free. However, this preferential treatment is scheduled to end in 2010, unless it is reenacted.

Virginia also has tax benefits available for certain Section 529 plans. Currently, taxpayers may subtract any income attributable to a distribution of benefits from a prepaid tuition contract or savings trust account with the Virginia College Savings Plan. In addition, the taxpayer may subtract any refunds from the account provided that the refund is in the event of a beneficiary's death, disability, or receipt of a scholarship.

Taxpayers may also deduct the amount paid or contributed during the taxable year for a prepaid tuition contract or savings trust account entered into with the Virginia College Savings Plan. The deduction in any taxable year is limited to $2,000 per contract or account. If the amount paid or contributed is over $2,000, the remainder may be carried over and subtracted in future taxable years, provided that the deduction never exceeds $2,000 in any taxable year. However, a purchaser or contributor who has attained age 70 is not subject to the $2,000 limitation.

The Virginia College Savings Plan offers three Section 529 investments opportunities. First, the Virginia Prepaid Education Program allows purchasers to prepay tuition and mandatory fees for children in the tenth grade or younger. Next, the Virginia Education Savings Trust is offered for students of all ages. Distributions from this program may be used for all major college expenses, including tuition, fees, room and board, textbooks, and required supplies and equipment. Finally, the CollegeAmerica plan is a program that is partnered with American Funds, a mutual fund company. This program also allows the purchaser to save for all major college expenses.

Proposal

This bill would allow a deduction to purchasers or contributors for the amount paid or contributed during the taxable year to qualified tuition programs as defined by § 529 of the Internal Revenue Code. However, this deduction would not be allowed for prepaid tuition contracts or savings trust accounts entered into with the Virginia College Savings Plan. Those plans fall under the deduction already allowed under Va. Code §§ 58.1-322(D)(7)(a) and 58.1-322(D)(7)(c).

This bill would limit the amount that may be deduction on any individual income tax return in any taxable year to $2,000 per designated beneficiary. However, no deduction will be allowed if the payments or contributions are deducted on the taxpayer’s federal income tax return. If the annual payment or contribution under the qualified tuition program exceeds $2,000 for a designated beneficiary, the remainder may be carried forward and subtracted in future taxable years until the total payments or contributions have been fully deducted.

Under this bill, any deduction taken would be subject to recapture in the taxable year or years in which distributions or refunds are made for any reason other than (i) to pay qualified higher education expenses, as defined in § 529 or (ii) the beneficiary's death, disability, or receipt of a scholarship.

This bill would define the term "purchaser" or "contributor" to mean the person shown as such on the records of the qualified tuition program as of December 31 of the taxable year. In the case of a transfer of ownership of a contract or account under such qualified tuition program, the transferee shall succeed to the transferor's tax attributes associated with the contract or account, including, but not limited to, carryover and recapture of deductions. This definition is identical to the one used under the deduction for the Virginia College Savings Plan.

Finally, this bill would remove the $2,000 per taxable year limitation for taxpayers who have attained the age of 70. Under this bill, a taxpayer aged 70 or older would be allowed a deduction for the full amount paid under a contract or contributed to an account on or after January 1, 2005, under the qualified tuition program.

This bill would be effective for taxable years beginning on and after January 1, 2005.

cc : Secretary of Finance

Date: 1/15/2005 AMS
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