DEPARTMENT OF TAXATION
2023 Fiscal Impact Statement

1. **Patron** Delores L. McQuinn

2. **Bill Number** HB 1740
House of Origin:
__X__ **Introduced**
_____ **Substitute**
_____ **Engrossed**

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

3. **Committee** House Finance

4. **Title** Individual and Corporate Income Tax; Credit for Employer Contributions to Virginia College Savings Plan Accounts, Etc.

5. **Summary/Purpose:**

This bill would phase in an increase to the maximum individual income tax deduction for amounts paid or contributed to a prepaid tuition contract or college savings trust account entered into with the Virginia College Savings Plan from $4,000 to $15,000 over three years. The maximum deduction amount would be adjusted annually for inflation. In addition, the deduction would continue to be limited to $4,000 for taxpayers with federal adjusted gross income that is greater than $100,000 ($200,000 for married persons filing a joint return).

The bill would also create a new individual and corporate income tax deduction for the amount that a child day center or child day program paid or contributed to a customer's or client's prepaid tuition contract or college savings trust account entered into with the Virginia College Savings Plan. Such deduction would be limited to $4,000 per customer's or client's prepaid tuition contract or college savings trust account.

This bill would provide an individual and corporate income tax credit equal to 35 percent of the expenses incurred by a business during the taxable year for contributions into a Virginia College Savings Plan account owned by a qualified employee of such business. The amount of the credit would generally be limited to $500 per qualified employee. However, the maximum credit would increase to $1,000 per employee for a contribution to an employee deemed not highly compensated. The credit would be subject to an annual credit cap of $5 million

If enacted during the 2023 Regular Session of the General Assembly, this bill would become effective July 1, 2023. The provisions of the bill generally pertain to taxable years beginning on and after January 1, 2023.

6. **Budget amendment necessary:** Yes.
Item(s): Page 1, Revenue Estates
Item 274 and 276, Department of Taxation

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

7a. Expenditure Impact:

Fiscal Year	***Dollars***	***Positions***	***Fund***
2023-24	$283,573	1	GF
2024-25	$75,898	1	GF
2025-26	$75,898	1	GF
2026-27	$75,898	1	GF
2027-28	$75,898	1	GF
2028-29	$75,898	1	GF

8. Fiscal implications:

Administrative Costs

The Department of Taxation ("the Department") estimates that this bill would result in additional administrative costs $283,573 in Fiscal Year 2024 and $75,898 in each fiscal year thereafter. These cost include the addition of one full-time employee and the expenses associated with creating a new tax credit program, including updating technology, forms, and systems.

The Virginia College Savings Plan considers implementation of this bill as routine and does not require additional funding.

Revenue Impact

This bill would have an unknown negative General Fund revenue impact. It is unknown how many individuals, employers, and day care providers may make additional contributions to Virginia 529 accounts that would qualify for the expansion of the existing deduction or the two proposed incentives for employers and day care providers.

The tax credit proposed by this bill would have an unknown negative General Fund revenue impact of up to $5 million annually beginning in Fiscal Year 2024. It is unknown to what extent employers would contribute to their employees' Virginia College Savings Plan accounts and claim this tax credit. However, the negative revenue impact would be limited by the $5 million annual credit cap.

The impact of the increases to the existing deduction for amounts paid or contributed to a Virginia College Savings Plan is also unknown. The impact could be fairly significant given current utilization of the deduction. In 2020, the deduction was claimed on 110,375 returns in an aggregate amount of $735 million. After applying the average effective tax rate of 5.4 percent to the amount claimed, the estimated negative General Fund revenue impact of the existing deduction was approximately $40 million for Taxable Year 2020.

After applying the income limitations set forth in this bill, approximately 54,000 individual returns would be eligible for the increased deduction amount. For Taxable Year 2023, this would increase the revenue impact of the deduction by approximately $10 million if these taxpayers increased their contributions and claimed the increased deduction amount. The impact in Taxable Year 2024 and thereafter would be even greater due to the further increases in the maximum deduction amount. However, it is unknown to what extent taxpayers would claim increased deduction amounts.

The impact of the proposed deduction day care providers is also unknown, but likely not as significant as the impact of the other two provisions.

9. Specific agency or political subdivisions affected:

Department of Taxation
Virginia College Savings Plan

10. Technical amendment necessary: Yes.

Final numbers for the consumer price index can take several months to be finalized by the United States Department of Labor. To ensure that the Department can publish the indexed limits in the forms and instructions used by taxpayers by January of each year, the Department recommends that the date upon which the indexing ratio is based be clarified. In addition, it is unclear how the amounts for Taxable Years 2023, 2024, and 2025 would be indexed, as a new amount is specified each year. To eliminate confusion, the Department suggests that such technical amendments also state that the indexing provisions would begin for Taxable Year 2026:

Lines 68, 226, 400, and 574, after "January 1,"
Strike: 2023
Insert: 2026

Lines 97, 255, 429, and 603, after "successor index"
Strike: for the most recent calendar year exceeds the C-CPI-U published at the close of the 12-month period ending on December 31, 2022.
Insert: for the 12-month period ending August 31 of the preceding year exceeds the C-CPI-U for the 12-month period ending August 31, 2025.

Under this bill, both the proposed tax credit and a Virginia 529 deduction could be claimed for the same contribution. If this is not the intent, the Department suggest the following technical amendments:

Lines 106, 265, 439, and 613, end of line
Insert: c. No deduction shall be allowed under subsection 7 (a) or (b) for a taxpayer who has claimed a deduction under § 58.1-402(I) or tax credit under § 58.1-439.12:13 for the same amount paid or contributed to a prepaid tuition contract or college savings trust account entered into with the Virginia College Savings Plan.

Line 734, end of line
Insert: G. No credit shall be allowed under this section for a taxpayer who has claimed a deduction under § 58.1-402(I) or § 58.1-322.03(7) for the same amount paid or contributed to a prepaid tuition contract or college savings trust account entered into with the Virginia College Savings Plan.

Line 1108, after "taxpayer

Insert: No deduction shall be allowed under this section for a taxpayer who has claimed a deduction under § 58.1-322.03(7) or tax credit under § 58.1-439.12:13 for the same amount paid or contributed to a prepaid tuition contract or college savings trust account entered into with the Virginia College Savings Plan.

The bill does not specify an effective date for the proposed individual income tax deduction for day care providers. To avoid confusion regarding when the deduction applies, the Department suggests the following technical amendment:

Lines 100, 258, 432, and 606, after "b."
Strike: A
Insert: For taxable years beginning on and after January 1, 2023, a

11. Other comments:

<u>Virginia College Savings Plan</u>

In 1996, Congress enacted Internal Revenue Code § 529, which allowed taxpayers to set up tax-advantaged college savings plans, also referred to as qualified tuition plans or Section 529 plans. Such plans are generally exempt from federal income tax. To qualify as a Section 529 plan, the plan must be operated by a state or educational institution. The Virginia College Savings Plan is an independent agency of the Commonwealth that administers Section 529 plans. Currently the Virginia College Savings Plan only offers *Invest 529* which is a savings plan that allows account owners to choose from a variety of investment options, including age-based evolving and non-evolving portfolios to meet a variety of investment objectives, risk tolerances, and college savings time horizons. Previously, Virginia College Savings Plan allowed prepaid tuition plans, but these plans are no longer available.

Because Virginia conforms to federal income tax law, Section 529 plans are also generally exempt from the Virginia income tax. As long as funds withdrawn from Section 529 plans are used for a qualifying educational purposes, including tuition for Kindergarten through 12^{th} grade beneficiaries, account owners do not pay income tax on the gains accumulated in Section 529 accounts. Virginia law also allows a subtraction for any income attributable to a distribution of benefits or a refund from a prepaid tuition contract or savings trust account with the Virginia College Savings Plan, provided that any income attributable to a refund is due to a beneficiary's death, disability, or receipt of a scholarship.

In addition, Virginia provides an individual income tax deduction for the purchaser or contributor for 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 amount deducted on any individual income tax return is generally limited to $4,000 per prepaid tuition contract or savings trust account.

<u>Sunset Dates for New Income Tax Credits and Sales Tax Exemptions</u>

Section 3-5.14 of the 2022 Appropriation Act provides that any new sales tax exemption or tax credit enacted by the General Assembly after the 2019 Session, but prior to the 2024 Session, must have a sunset date of not later than June 30, 2025.

Proposed Legislation

Individual Income Tax Virginia 529 Deduction

This bill would generally increase the maximum individual income tax deduction for amounts paid or contributed to a prepaid tuition contract or college savings trust account entered into with the Virginia College Savings Plan from $4,000 per prepaid tuition contract or college savings trust account to $7,500 for Taxable Year 2023, $11,000 for Taxable Year 2024, and $15,000 for Taxable Year 2025 and thereafter. Such amounts would be adjusted each year by an indexing ratio, defined as the percentage, if any, by which the Chained Consumer Price Index for All Urban Consumers (C-CPI-U) as published by the U.S. Department of Labor, or any successor index, for the most recent calendar year exceeds the C-CPI-U published at the close of the 12-month period ending on December 31, 2022. If the percentage is less than zero, the indexing ration would be zero.

However, the deduction would continue to be limited to the current amount of $4,000 per prepaid tuition contract or college savings trust account for taxpayers with federal adjusted gross income that is greater than $100,000 ($200,000 for married persons filing a joint return).

Virginia 529 Deduction for Day Care Providers

The bill would also create a new individual and corporate income tax deduction for the amount that a child day center or child day program paid or contributed to a customer's or client's prepaid tuition contract or college savings trust account entered into with the Virginia College Savings Plan. Such deduction would be limited to $4,000 per customer’s or client’s prepaid tuition contract or college savings trust account.

“Child day center” would mean a child day program offered to (i) two or more children under the age of 13 in a facility that is not the residence of the provider or of any of the children in care or (ii) 13 or more children at any location.

“Child day program” would mean a regularly operating service arrangement for children where, during the absence of a parent or guardian, a person or organization has agreed to assume responsibility for the supervision, protection, and well-being of a child under the age of 13 for less than a 24-hour period.

The bill does not specify an effective date for the new individual income tax deduction. The proposed corporate income tax deduction would be effective for taxable years beginning on and after January 1, 2023.

Virginia 529 Tax Credit for Employers

This bill would provide an individual and corporate income tax credit equal to 35 percent of the expenses incurred by a business during the taxable year for contributions into a Virginia College Savings Plan account owned by a qualified employee of such business. The amount of the credit would generally be limited to $500 per qualified employee. However, the maximum credit would increase to $1,000 per employee for a contribution to an employee deemed not highly compensated.

The credit would be subject to an annual credit cap of $5 million. If applications for credits exceed $5 million for any taxable year, the credits would be allocated on a pro rata basis.

"Qualified employee" would be defined as an employee of a business eligible for this credit in a full-time position requiring a minimum of 1,680 hours in a normal fiscal year of the business's operations if the standard fringe benefits are paid by the business for the employee and the employee currently resides in Virginia. Seasonal or temporary employees, owners, or relatives would not be included as qualified employees.

“Owner" would be defined as an individual who owns, directly or indirectly, more than a five percent interest in the business claiming the credit.

"Relative" would be defined as a spouse, child, grandchild, parent, or sibling of an owner.

“Not highly compensated” would be defined as a qualified employee whose income is less than Virginia’s median wage, as reported by the Virginia Employment Commission, in the taxable year prior to a business’s applying for the credit.

The amount of the credit claimed in any single taxable year would be limited to the taxpayer’s income tax liability for the taxable year. If the amount of credits exceeds the taxpayer’s tax liability for the taxable year in which the contributions were made, the taxpayer would be allowed to carry over the excess for credit against income taxes for the next three years or until the total amount of the tax credit has been taken, whichever occurs first. No credits would be permitted to be applied retroactively to taxable years prior to the taxable year in which the contributions were made.

Credits granted to a partnership, electing small business corporation (S corporation), or limited liability company would be required to be allocated to the individual partners, shareholders, or members, respectively, in proportion to their ownership or interest in such business entity.

This bill would require the Department, in consultation with the Virginia College Savings Plan, to develop guidelines, exempt from the Administrative Process Act, for claiming the credit. This bill would also require the Department to submit an annual report to the Chairmen of the House Finance Committee and Senate Finance and Appropriations Committee regarding the status and implementation of the credit.

If enacted during the 2023 Regular Session of the General Assembly, this bill would become effective July 1, 2023. The provisions of the bill generally pertain to taxable years beginning on and after January 1, 2023.

Similar Legislation

House Bill 1367 would provide an identical tax credit, but would not provide for any changes to the current Virginia 529 deduction.

cc : Secretary of Finance

Date: 1/29/2023 RWC
HB1740F161