

Department of Finance and Administration

Legislative Impact Statement

Bill: HB1122 (Proposed Amendment No. 1)

Bill Subtitle: AN ACT FOR THE OFFICE OF THE TREASURER OF STATE APPROPRIATION FOR THE 2018-2019 FISCAL YEAR.

Sponsors: Senator Rapert and Representative Dotson

Basic Change:

HB1122 makes an appropriation for personal services, operating expenses and data processing system/services for the office of the State Treasurer for the fiscal year ending June 30, 2019.

Proposed Amendment No. 1 to HB1122 would amend the Arkansas Tax-Deferred Tuition Savings Program Act, § 6-84-101 et seq. to readopt federal income tax law in Internal Revenue Code (IRC) § 529 that has previously been incorporated into Arkansas income tax law but has been subsequently amended by the U.S. Congress in the Tax Cuts and Jobs Act, Pub. Law 115-97 (TCJA). These changes would provide that Arkansas taxpayers would have the same rules for determining which educational expenses are eligible “qualified higher education expenses” for both federal and state income tax purposes.

Under Pre-TCJA Federal Law, funds in an IRC § 529 savings account could only be used for qualified higher education expenses. If funds were withdrawn from the account for other purposes, each withdrawal was treated as containing a pro-rata portion of earnings and principal. The earnings portion of a nonqualified withdrawal was taxable as ordinary income and subject to a 10% additional tax unless an exception applied. “Qualified higher education expenses” included tuition, fees, books, supplies, and required equipment, as well as reasonable room and board if the student was enrolled at least half-time. Eligible schools included colleges, universities, vocational schools, or other postsecondary schools eligible to participate in a student aid program of the Department of Education. This included nearly all accredited public, nonprofit, and proprietary (for-profit) postsecondary institutions.

A taxpayer may take a deduction of no more than \$5,000.00 on his or her Arkansas individual income tax return for contributions made to an Arkansas tuition savings account or up to \$3,000 for contributions to an out-of-state tuition savings account. If the aggregate amount of contributions by a taxpayer during a tax year exceeds the \$5,000.00 limit, the unused aggregate amount may be carried forward for the next four succeeding years. Federal law does not provide an income tax deduction for contributions to a IRC § 529 plan. Contributions to an IRC § 529 plan are made with after-tax (non pre-tax) dollars.

New Federal law under the TCJA. For distributions after Dec. 31, 2017, “qualified higher education expenses” include tuition at an elementary or secondary public, private, or religious school. IRC § 529 (c)(7), as added by Act Sec. 11032(a). The proposed amendment to Arkansas law would adopt the new federal definition of “qualified higher education expenses” to adopt this federal change.

Revenue Impact:

Assuming every Arkansas private school family took full advantage of the 529 plan the financial impact would be approximately **\$5.2 million** per year. This estimated financial impact is based on new 529 plans being created for the tuition costs of private school K-12 students by families that do not have existing 529 plans or that have additional 529 plans set up by other family members.

Under this amendment, a Taxpayer that currently has a 529 plan could now use the withdrawals for tuition at an elementary or secondary public, private, or religious school. In this instance there would be

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no revenue impact since the tax deduction for the contribution was taken in prior tax years.

The Arkansas Department of Education's website reports there were 479,528 public school students for FY18. The Arkansas Nonpublic School Accrediting Association's website states there were 19,490 students in private schools for FY17. The Private School Review website reports there are 179 private schools in Arkansas serving 29,559 students with an average cost of \$5,607 per student in FY17. The highest cost is \$26,400.

For purposes of estimating the Arkansas impact the following assumptions were used:

1. 24,525 private school students (the average of the two reported number of students (19,490 + 29,559));
2. Average tuition cost exceeds the maximum deduction for a single taxpayer of \$5,000 so using the maximum deduction; and
3. The effective individual income tax rate for 2016 is 4.25%.

Taxpayer Impact:

Arkansas taxpayers will have the same rules under federal and state qualified higher education expenses purposes.

Resources Required:

Tax forms and instructions, return processing, and training procedures will need to be updated to reflect new provisions in the Internal Revenue Code Sections that were previously adopted. Tax community will need to be informed of the changes.

Time Required:

Adequate time is provided.

Procedural Changes:

None.

Other Comments:

None.

Legal Analysis:

Under current Arkansas law, a qualified withdrawal from an Arkansas Tax-Deferred Tuition Savings Program account may be used to pay qualified higher education expenses associated with attending a post-secondary school. Eligible expenses include tuition, fees, books, supplies and other required equipment.

In December 2017, federal law was amended to expand the scope of "qualified higher education expenses" to include tuition paid to attend an elementary or secondary public, private or religious school. The proposed amendment to Arkansas law would adopt the new federal definition of qualified higher education expenses and would be effective for tax years beginning on or after January 1, 2018.

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Substantive provisions of appropriations bills must have a direct relation to the topic of the appropriation, and not just relate to the general topic under Article 5, §§ 29 & 30 of the Arkansas Constitution. *Ark. Motor Carriers Ass'n v. Pritchett*, 303 Ark. 620 (1990). This factually intensive analysis must determine whether the appropriation bill does not alter or change existing obligations under the law. See, e.g., *Clinton v. Taylor*, 284 Ark. 238 (1984).