



## Tax & Budget

### Testimony on SB 22 before the House Ways and Means Committee

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Good morning, Chairman Schaffer, Vice Chair Scherer, Ranking Member Rogers and members of the Committee. My name is Victoria Jackson and I am a State Policy Fellow with Policy Matters Ohio, a nonprofit, nonpartisan organization with the mission of creating a more vibrant, equitable, sustainable and inclusive Ohio. Thank you for the opportunity to submit testimony. The General Assembly should not conform CollegeAdvantage, Ohio's 529 plan, to the new federal tax law. Doing so would double the cost of Ohio's tax break for 529 plans from \$20.5 million to \$40.5 million per year.

The new federal tax law allows tax-advantaged college savings and investment accounts, known as 529 plans, to be used to pay for K-12 tuition at private and parochial schools. Originally, 529 accounts were intended to help families save and invest for college by providing tax deductions for contributions. Any earnings from the investments would be tax-free at the state and federal level.<sup>1</sup> Because most middle- and low-income people can't save a great deal for college, these plans are primarily used by higher-income people. Until now, these accounts were restricted to higher education expenses. That is still the law in Ohio, and Ohio law does not automatically conform to federal law to allow the plans to pay for K-12 tuition. We should keep our law as it is. If Ohio allows these plans to be used for K-12 tuition, it would be at the expense of revenue that supports public schools. Policymakers should instead expand opportunity for all Ohioans — especially low-income students — by increasing support for the Ohio College Opportunity Grant, the state's only need-based aid grant.<sup>2</sup>

#### Tax deductions are costly

CollegeAdvantage is Ohio's 529 plan. It has two main tax breaks: The state waives income tax on withdrawals for qualified higher education expenses and allows up to \$4,000 in contributions to be deducted from state income tax. In 2017, lawmakers increased the deduction for contributions from \$2,000 to \$4,000 per beneficiary, per year. By increasing this tax break, the state expects to forgo about \$20.5 million and \$21.9 million in fiscal years 2018 and 2019 respectively, with losses going up by 4 to 8 percent every year.<sup>3</sup> The state could lose even more if account holders can deduct contributions for K-12 tuition.

Although the amendments to Senate Bill 22 have not been released yet, it appears the House intends to align Ohio's 529 plan to federal law. This would require changing state law to make K-12 tuition a qualifying education expense, which would make contributions tax deductible and make gains from investments tax exempt, which would increase forgone revenue to the state by about \$20 million more per year based on estimates from the Ohio Department of Taxation.<sup>4</sup> The General Assembly should not align Ohio law with this federal provision because it isn't about making college more affordable for Ohioans, but further cutting taxes for the wealthy, who can already afford private school tuition.

#### Who uses 529 plans

In Ohio, 529 plans are overwhelmingly used by high-income taxpayers who can afford to save for college. Based on 2015 income tax data, taxpayers with federal adjusted gross income of more than \$100,000 took two and a half times more deductions than taxpayers with incomes below \$100,000. Moreover, Ohio taxpayers with incomes of \$200,000 or more

<sup>1</sup> Ohio Tuition Trust Authority. "Supplement to the Direct Plan Offering Statement and Participation Agreement Dated September 8, 2016 Effective January 1, 2018," September 8, 2016. <http://bit.ly/2FdSyeL>

<sup>2</sup> Halbert, Hannah, and Ester Khaykin. "Post 2018-2019 Budget Bite: Affordable College." Policy Matters Ohio. Accessed February 16, 2018. <http://www.policymattersohio.org/research-policy/quality-ohio/revenue-budget/post-2018-2019-budget-bite-affordable-college>.

<sup>3</sup> "Tax Expenditure Report Governor John R. Kasich Department of Taxation Tax Commissioner Joseph Testa The State of Ohio Executive Budget Fiscal Years 2018-2019." Ohio Department of Taxation, November 25, 2016. <http://bit.ly/2EB7RgI> and Keller, Russ. "Fiscal Note & Local Impact Statement Senate Bill 5." Ohio Legislative Service Commission, <http://bit.ly/2GsqHH8>

<sup>4</sup> Ohio Department of Taxation. Conformity estimates S.B. 22 2/19/18

accounted for 3.9 percent of all state tax returns in 2015 but took 28 percent of CollegeAdvantage deductions.<sup>5</sup> These accounts allow capital gains and dividends from stocks to grow without being taxed. Wealthy people get the greatest tax benefits from these plans both because they pay a higher tax rate, so the deduction is worth more, and because they can invest the most money. This change will encourage people who use the account for K-12 tuition to receive the deduction.

### **A tax break for the super wealthy**

Even more than with earlier 529 plans, federal tax breaks for K-12 tuition will most benefit the extremely wealthy who can afford to make lump sum contributions in the hundreds of thousands of dollars. The new law allows 529 plan account holders to withdraw up to \$10,000 in capital gains annually tax-free, resulting in a federal tax break of about \$2,380 for account holders in the highest tax bracket.<sup>6</sup> To reap the full \$2,380 tax cut, an account holder would need to “superfund” the account by contributing a massive sum of money, then paying for private school from the capital gains the account earns every year.<sup>7</sup> To get the full benefit, a taxpayer would have to deposit around \$200,000.<sup>8</sup> If a very wealthy family with a child wanted to use the new tax break to pay K-12 tuition, they could fund the account with a \$200,000 contribution to a mutual fund when their child is four years old. Assuming a 6 percent rate of return, the family would earn about \$12,000 by the time the child starts kindergarten. If kindergarten costs \$11,000, the family could use the capital gains to pay for tuition and \$10,000 of the payment would be tax exempt. Each year they would pay for school from the capital gains and still have plenty of money to pay for college. This change is not about education, it’s about cutting taxes for the very wealthy.

### **Recommendations**

The tax deduction for 529 plans is already estimated to cost the state about \$22 million in the year beginning July 1. If Ohio aligns its 529 plan with the new federal law, state revenue that funds public education would likely decrease.

We ask that you not allow contributions to 529 plan college savings accounts to be used to pay for K-12 private and parochial school tuition. CollegeAdvantage is primarily used by the upper income and does little to help middle- and low-income people. If Ohio adopts this proposal it will prioritize tax cuts for the wealthy over revenue to support public education, which educates the vast majority of Ohio’s children.

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<sup>5</sup> “Table Y-1: Summary of Ohio Individual Income Tax Returns, Tax Year 2015.” Ohio Department of Taxation, May 15, 2017. <http://bit.ly/2FdVNmr>  
\$200,000 is federal adjusted gross income.

<sup>6</sup> Tax Policy Center Urban Institute & Brookings Institution. “How Are Capital Gains Taxed?” Tax Policy Center. Accessed February 16, 2018. <http://www.taxpolicycenter.org/briefing-book/how-are-capital-gains-taxed>

<sup>7</sup> Joo, Richard V. Reeves and Nathan. “A Tax Break for ‘Dream Hoarders’: What to Do about 529 College Savings Plans.” Brookings (blog), June 29, 2017. <https://www.brookings.edu/research/a-tax-break-for-dream-hoarders-what-to-do-about-529-college-savings-plans/>

<sup>8</sup> Lieber, Ron. “Yes, You Really Can Pay for Private School With 529 Plans Now.” The New York Times, December 21, 2017, sec. Your Money. <https://www.nytimes.com/2017/12/21/your-money/529-plans-taxes-private-school.html>.