Fiscal Note & Local Impact Statement

123 rd General Assembly of Ohio

BILL: **Sub. S.B. 161**

DATE: **December 7, 1999**

STATUS: **As Passed by the Senate**

SPONSOR: **Sen. Gardner**

LOCAL IMPACT STATEMENT REQUIRED: **Yes**

CONTENTS: **Establishes a variable college savings program through the Ohio Tuition Trust Authority and provides for a state income tax deduction for saving under both the new and existing programs.**

State Fiscal Highlights

STATE FUND	FY 2000	FY 2001	FUTURE YEARS
General Revenue Fund			
Revenues	Loss of $3.4 million or more	Loss of $4.3 million or more	Loss of $5.3 million or more in future years if contributions continue increasing
Expenditures	- 0 -	- 0 -	- 0 -
Tuition Trust Authority			
Revenues	Offsetting increase	Offsetting increase	Offsetting increase
Expenditures	Minimal increase	Minimal increase	Minimal increase

Note: The state fiscal year is July 1 through June 30. For example, FY 2000 is July 1, 1999 – June 30, 2000.

- OTTA has set its sales revenue goal at $65.8 million in FY 2000 and $82.1 million in FY 2001 for the Prepaid Tuition Plan. Sales revenues have been growing by approximately 25 percent per year. OTTA sales revenues will most likely increase with the creation of the Variable Savings Plan and the addition of the state income tax deduction as more people find it advantageous to invest with OTTA for future education expenses. The state will likely lose more in state income tax revenue than the thresholds listed above.

- Administrative costs will increase for the Tuition Trust Authority. Service fees paid by program participants will offset these costs.

Local Fiscal Highlights

LOCAL GOVERNMENT	FY 2000	FY 2001	FUTURE YEARS
LLGSF (primarily used for funding libraries)			
Revenues	Loss of $218,000 or more	Loss of $272,000 or more	Loss of $340,000 or more in future years if contributions continue increasing
LGF and LGRAF (funds go to all local governments)			
Revenues	Loss of $184,000 or more	Loss of $229,000 or more	Loss of $287,000 or more in future years if contributions continue increasing
Expenditures	- 0 -	- 0 -	- 0 -

- The loss in state income tax revenue results in a loss in tax collections to local governments and libraries through the Local Government Fund (LGF), Local Government Revenue Assistance Fund (LGRAF), and Library and Local Government Support Fund (LLGASF). These funds receive 4.2%, 0.6%, and 5.7% of state income tax collections respectively.

- The proposed tax deduction leads to income tax losses for the three local government funds and will vary based on program participation. It is likely that these funds will lose more income tax revenue than the thresholds listed above.

Detailed Fiscal Analysis

This bill authorizes the Ohio Tuition Trust Authority (OTTA) to create a new variable college savings program. This program allows participants to take advantage of section 529 of the Internal Revenue Code established by the United States Congress in 1996 that allows for tax-deferred savings for educational purposes. This new program offers an alternative to other OTTA programs by offering participants an investment vehicle that has a higher investment risk, but also a potentially higher rate of return as the plan is linked to market performance. There is no guarantee that this plan will keep pace with tuition inflation.

OTTA currently administers the Prepaid Tuition Program, which enables participants to purchase units for credit towards future tuition expenses at today's prices. This program differs from the variable college savings program in that the program is guaranteed to keep pace with tuition inflation and is backed by the full faith and credit of the state. This program began in 1989, and by FY 1999; OTTA had over 82,000 children enrolled in this program with assets totaling $409 million.

This bill also allows for a state income tax deduction of up to $2000 per beneficiary per year for contributions to either a Prepaid Tuition or Variable Savings Plan account. Any excess may be carried forward to future years until the amount of the purchases and contributions is fully deducted. The tax savings for an Ohio taxpayer equals the amount deducted multiplied by the tax return's applicable marginal income tax rate. Thus, for a taxpayer in the $40,000 to $80,000 income tax bracket, the value of a $2,000 deduction is $104 ($2,000 X 0.05201) in tax savings. Contributions may be made to either or both of the plans offered by OTTA.

In addition the state tax benefits, proceeds of qualified state plans such as the Prepaid Tuition Plan or the Variable Savings Plan are federally tax deferred. These earnings are taxed at the student's rate only when used to pay for qualified educational expenses. Lump sum investments of up to $50,000 per child are allowable per year without being subject to a federal gift tax.

The chart below provides a summary of the differences and similarities of the two savings plans.

Program Benefits	**Prepaid Tuition Plan**	**Variable Savings Plan**
Guaranteed by the state	X	
Guaranteed to keep pace with inflation	X	
Earns market returns		X
Federally tax-deferred	X	X
State tax-exempt, $2000 state tax deduction	X	X
Use at any college, university, or vocational school	X	X

Experience in Other States

According to data from the College Savings Plan Network, thirty-one states either currently offer a college savings program or have a program scheduled to begin by the end of 2000. The change in the federal tax law in 1996 that enabled families to defer taxes on savings for education prompted many states to begin to offer college savings plans.

New York has had a college savings program for one year. As of October 1999, 64,859 accounts had been opened – representing 0.36 percent of the total population of the state. Program assets total $237,458,266, which equates to an average of $3661 per account. Contributions to these accounts are subject to a lifetime maximum contribution of $100,000 per beneficiary. An annual maximum of $5000 per person or $10,000 per married couple is exempt from New York state income tax. New York plan officials note that account contributions vary widely in amount.

In Massachusetts the savings program, known as U.Fund, has been operational since March 1999. U.Fund is not exempt from state tax. Contributions are capped at $158,750 for 1999, roughly the cost of 4 years of room and board at a more expensive private institution. U.Fund officials report that in the first 6 months of operation the program attracted over 11,000 participants with program assets totaling $60 million or an average contribution of $5500. While there have been a number of large contributions to accounts, plan officials report that most people contribute a small amount on a monthly basis.

Delaware has had a savings program for one year. During the first year the plan opened 750 accounts and had assets totaling $4 million. This equates to an average contribution of $5333 per account. The plan reports that almost one third of all new accounts were opened by people living out of state.

State Expenditures

Actual administrative costs will not be known until the program is designed by OTTA. Additional staff people will mostly likely be needed to keep pace with the added demand. OTTA will also have additional expenses if it decides to contract with an outside vendor to manage the program's funds. Administrative fees paid by program participants will offset these expenditures, as OTTA is a self-funded agency.

State and Local Revenues

In the biennial budget request OTTA set its sales revenue goals for the Prepaid Tuition Plan at $65.8 million in FY 2000 and at $82.1 million in FY 2001. These projections assume that each new account will purchase 40 tuition units and each existing account will purchase 12 tuition units per year. At the 1999 rate of $45.23 per tuition unit, these projections equate an investment of $1809 per new account and $543 per existing account, which are well below the tax deduction cap of $2000. With sales revenues at the current projected level, the state will see a loss in income tax revenue due to the tax deduction of $3.4 million in FY 2000 and $4.3 million in FY 2001. If OTTA sales revenues continue to grow by approximately 25 percent, in FY 2002 sales revenues will amount to $102.6 million and the corresponding loss in state tax revenue will be $5.3 million.

Several local government funds will also be affected by the tax deduction, namely the Local Government Fund (LGF), Local Government Revenue Assistance Fund (LGRAF), and Library and Local Government Support Fund (LLGASF). The LGF and LGRAF will see a loss of $184,000 in FY 2000 and $229,000 in FY 2001. These two funds provide monies to local governments. The LLGASF will see a loss of $218,000 in FY 2000 and $272,000 in FY 2001. This fund provides monies to local libraries. Again, if sales revenues continue to increase by 25 percent in FY 2002 the loss will total $340,000 for the LLGASF and $287,000 for the LGF and LGRAF.

It is likely that contributions to OTTA will increase by more than 25 percent per year with the addition of the Variable Savings Plan. The new tax deduction as well as the addition of a college savings plan with a potentially higher return on investment should attract more program participation. In addition, qualified withdrawals from either program are taxed federally as income to the student and not to the contributor, which provides an additional tax incentive for investment. Any increases in OTTA sales revenue will further reduce state and local revenues from income tax.

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