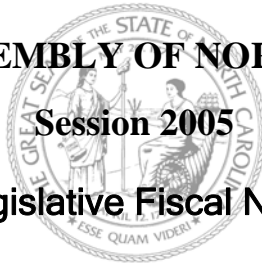


GENERAL ASSEMBLY OF NORTH CAROLINA



Session 2005

Legislative Fiscal Note

**BILL NUMBER:** Senate Bill 1259 (First Edition)

**SHORT TITLE:** Parental Savings Trust Fund Tax Deduction.

**SPONSOR(S):** Senator Boseman

| <b>FISCAL IMPACT</b>  |                          |                          |                                  |                          |                          |
|---|--------------------------|--------------------------|----------------------------------|--------------------------|--------------------------|
|   | <b>Yes (X)</b>           | <b>No ( )</b>            | <b>No Estimate Available ( )</b> |                          |                          |
|   | <b>(in millions)</b>     |                          |                                  |                          |                          |
|   | <b><u>FY 2006-07</u></b> | <b><u>FY 2007-08</u></b> | <b><u>FY 2008-09</u></b>         | <b><u>FY 2009-10</u></b> | <b><u>FY 2010-11</u></b> |
| <b>REVENUES:</b>  | <b>(1.8)</b>             | <b>(2.3)</b>             | <b>(2.8)</b>                     | <b>(3.6)</b>             | <b>(4.5)</b>             |
| <b>POSITIONS</b><br><b>(cumulative):</b>  |                          |                          |                                  |                          |                          |
| <b>PRINCIPAL DEPARTMENT(S) &amp; PROGRAM(S) AFFECTED:</b> Department of Revenue;<br>North Carolina National College Savings Program |                          |                          |                                  |                          |                          |
| <b>EFFECTIVE DATE:</b> Taxable years beginning on or after January 1, 2006  |                          |                          |                                  |                          |                          |

**BILL SUMMARY:** The North Carolina National College Savings Plan is a 529 college savings plan created by the State Educational Assistance Authority and administered by College Foundation of North Carolina (CFNC). Under current law, earnings on 529 college savings accounts are exempt from state and federal tax. In addition, withdrawals from 529 savings accounts are tax-free when used to pay qualified educational expenses. Senate Bill 1259 allows contributions into the North Carolina College Savings Program to be tax-deductible up to \$5,000 per beneficiary or \$10,000 per program participant with multiple beneficiaries.

If funds are withdrawn from a National College Savings Plan account and used for purposes other than qualified higher education expenses, the amount withdrawn and deducted in a prior taxable year must be added to NC taxable income. This provision does not apply in the event of the death or disability of the designated beneficiary.

**ASSUMPTIONS AND METHODOLOGY:** CFNC supplied Fiscal Research with both participation and contribution data for the National College Savings Program from 2002 through

2005. The following chart provides detail on both categories as well as recent trends for each category of program participant.

| <b>Actual 2005 Participation and Contributions to National College Savings Program</b> |                    |                    |                          |                    |
|--|--------------------|--------------------|--------------------------|--------------------|
|  | Participation      |                    | Contributions            |                    |
|  | Number of accounts | % change from 2004 | Total 2005 Contributions | % change from 2004 |
| <b><i>Participants with one beneficiary</i></b>  |                    |                    |                          |                    |
| Total contribution per beneficiary \$5,000 or less                                     | 5,097              | 8.14%              | 6,338,202                | 4.56%              |
| Total contribution per beneficiary greater than \$5,000                                | 483                | -27.74%            | 5,748,782                | -40.52%            |
| <b><i>Participants with multiple beneficiaries</i></b>                                 |                    |                    |                          |                    |
| Total contribution per beneficiary \$5,000 or less                                     | 3,610              | 13.10%             | 9,384,375                | 10.30%             |
| Total contribution per beneficiary greater than \$5,000                                | 588                | -5.27%             | 14,703,326               | -7.99%             |

The National College Savings Program converted from a broker-sold plan to direct-sold in 2005. Program participants can choose from a variety of investment options for their individual plan and do not need to enlist the services of a financial planner to manage their 529 program contributions.<sup>1</sup> Also in 2005, CFNC expanded its existing investment options to include ten Vanguard funds, which charge very low management fees relative to other commonly found 529 funds and have exhibited strong performance in recent years. The elimination of broker fees and the addition of more attractive investment options are intended to generate higher participation in the program.

Most states that offer 529 savings programs offer some form of state tax benefit to participants, most commonly in the form of a tax deduction equivalent to contributions. While some states offer an unlimited deduction, most cap the amount of the deduction at a certain level. The deduction created in this bill is comparable to other states with tax rates similar to North Carolina.

The fiscal impact of this bill assumes 10.8% annual growth in allowable deductions, which is the average growth in allowable deductions across all categories of National College Savings Program participant from 2002 to 2005. In 2005, College Foundation estimated the creation of a tax deduction for contributions would result in an annual 22% increase in contributions; however, the performance of comparable direct-sold state 529 programs suggests a lower growth rate in allowable deductions is more likely.<sup>2</sup>

<sup>1</sup> Direct-sold plans are almost always lower-cost than broker-sold plans and have, at times, even out-performed broker-sold plans. In addition, a 2002 USA Today study concluded that in some instances, the annual fees charged by brokers outweighed earnings.

<sup>2</sup> State-administered 529 college savings programs that have exhibited high growth (greater than 15% to 20% annually) in both participation and fund value are primarily broker-sold 529 programs like Virginia's CollegeAmerica program. Broker-sold 529 programs are different than direct sale 529 programs in that they are highly competitive and often pull significant numbers of out-of-state residents as participants. Broker-sold programs also tend to attract more high-income investors despite their higher cost. Due to these differences, fund value growth rate for broker-sold 529

| <b>Estimated Impact of Senate Bill 1259</b><br>(assumes 10.8% annual growth in allowable deductions) |                    |                    |                    |                    |                    |
|--|--------------------|--------------------|--------------------|--------------------|--------------------|
|  | 2006-07*           | 2007-08            | 2008-09            | 2009-10            | 2010-11            |
| <i>One beneficiary</i>   |                    |                    |                    |                    |                    |
| \$5000 or less   | 7,023,995          | 9,257,625          | 12,201,550         | 16,081,643         | 21,195,606         |
| More than \$5000   | 2,676,303          | 2,732,505          | 2,789,888          | 2,848,476          | 2,908,294          |
| <i>Multiple beneficiaries</i>  |                    |                    |                    |                    |                    |
| \$5000 or less, or less than \$10,000 per participant  | 10,399,764         | 14,258,076         | 19,547,823         | 26,800,065         | 36,742,889         |
| More than \$5000, or more than \$10,000 per participant  | 6,242,426          | 6,186,244          | 6,130,568          | 6,075,392          | 6,020,714          |
| Total allowable deductions   | 26,342,488         | 32,434,451         | 40,669,829         | 51,805,576         | 66,867,503         |
| <b>Estimated fiscal impact</b>   | <b>\$1,843,974</b> | <b>\$2,270,412</b> | <b>\$2,846,888</b> | <b>\$3,626,390</b> | <b>\$4,680,725</b> |

**SOURCES OF DATA:** College Foundation of North Carolina

**TECHNICAL CONSIDERATIONS:** None

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Fiscal Research Division

**DATE:** May 17, 2006



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programs does not constitute a realistic expectation for the National College Savings Program. Considering the current estimated growth rate for NC personal income is 8%, the 10.8% growth used in this projection is realistic.