April 12, 2007

Department of Revenue
Analysis of H. F. 2106 (Gottwalt)

Effective beginning with tax year 2007.

EXPLANATION OF THE BILL

Current Law: A qualified tuition program, as defined under Section 529 of the Internal Revenue Code, allows a taxpayer to make contributions to an account that is established for the higher education expenses of a designated beneficiary. Earnings on the account are not taxed as they accrue, and distributions used for qualified higher education expenses are excluded from income. Under current Minnesota law, the income exclusion is in effect through 2010, whereas recent federal legislation removed the sunset date and made the exclusion permanent.

Proposed Law: For purposes of the individual income tax, the bill would allow a subtraction from taxable income for contributions to a college savings plan (qualified tuition program) qualifying under Section 529 of the Internal Revenue Code. The maximum subtraction would be $5,000 per beneficiary. The subtraction would be allowed for contributions made during the tax year and would not include amounts rolled over from another plan.

REVENUE ANALYSIS DETAIL

Minnesota College Savings Plan

- The estimate is based primarily on information provided by the Minnesota Office of Higher Education. In 2006, 19,114 account owners made contributions of $105 million into accounts for 32,113 beneficiaries through the Minnesota College Savings Plan. Minnesota residents account for 78% of the contributions.
- In 2006, 5,280 beneficiary accounts received contributions in excess of $5,000.
- In 2006, 26,833 beneficiary accounts received contributions that totaled less than $5,000. The average contribution for accounts receiving less than $5,000 was $1,214 in 2006.
- The Minnesota College Savings Plan is a “direct sold” plan, meaning that there is no broker involved and investments are made directly with the plan.
REVENUE ANALYSIS DETAIL (Continued)

Other Qualified Tuition Programs

- Based on information from the Minnesota Office of Higher Education, it is estimated that approximately 79% of all contributions to qualified tuition programs made by Minnesota residents are made through brokers to Section 529 plans other than the Minnesota College Savings Plan.
- For those investments made through a broker to other Section 529 qualified plans, the estimated number of beneficiaries receiving more than $5,000 per year and the average contribution for beneficiaries receiving less than $5,000 per year were increased by 20% because it was assumed that individuals making larger investments are more likely to use the services of a broker.

All Programs

- An average marginal tax rate of 7.2% was used.
- The current-law forecast of contributions for 2007 through 2011 was provided by TIAA-CREF, which is the Minnesota College Savings Plan vendor. It was assumed that the growth in contributions to all plans would be similar to the forecast for the Minnesota plan.
- Participation may increase due to the availability of the deduction. For this reason, the estimate for tax year 2007 was increased by 5% and for subsequent years by 10%.
- Tax year impact was allocated to the following fiscal year.

Number of Taxpayers: In 2006, an estimated 80,000 Minnesota residents made contributions to Section 529 qualified tuition programs on behalf of about 119,000 beneficiaries.

Source: Minnesota Department of Revenue
Tax Research Division
http://www.taxes.state.mn.us/taxes/legal_policy

hf2106_1/kfk