DEPARTMENT OF AUDITS AND ACCOUNTS

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January 20, 2021

Honorable Philip Singleton
State Representative
501-B Coverdell Legislative Office Bldg.
Atlanta, Georgia 30334

SUBJECT: Fiscal Note
House Bill (LC 43 1723)

Dear Representative Singleton:

The bill would exclude from state income taxation certain withdrawals from the Georgia Higher Education Savings Plan (GHESP) that are treated under current federal and state laws as "non-qualified" withdrawals and thus taxable. Effective July 1, 2021, withdrawals made "in connection with the beneficiary successfully enlisting for active duty in … the armed forces of the United States" (hereafter enlistment withdrawals) would not be subject to state income tax. Similar withdrawals from 529 Plans other than GHESP would not be excluded.

GHESP is a "qualified tuition program" under 26 U.S. Code § 529 (529 Plan), providing a tax advantaged savings option for qualified education expenses of a specified beneficiary. Withdrawals for non-qualified purposes are subject to federal and state income tax (and penalties at the federal level). The bill would not affect federal tax or penalties.

Impact on State Revenue

Georgia State University's Fiscal Research Center (FRC) was unable to project the bill's impact on state revenue, but for reasons explained in the appendix, noted that it is likely that the bill would reduce revenue by less than $1 million annually.

FRC noted that data on current 529 plan withdrawals are not available; therefore, it is not possible to estimate what portion of those withdrawals would qualify under the bill. However, information shown in the appendix provides information about total non-qualified withdrawals from GHESP, military enlistment by Georgians, and other factors that may be suggestive of the potential magnitude of the state revenue impact.

Impact on State Expenditures
The Department of Revenue would be able to implement the provisions of this bill with existing resources.

Sincerely,

/s/ Greg S. Griffin
Greg S. Griffin
State Auditor

/s/ Kelly Farr
Kelly Farr, Director
Office of Planning and Budget

GSG/KF/mt

Analysis by the Fiscal Research Center

GHESP is a qualified tuition program under 26 U.S. Code § 529, enabling taxpayers to save and pay for certain education expenses on a tax advantage basis in separate accounts for specified beneficiaries. Income earned in the accounts is not subject to income tax if used to pay for qualified education expenses. Non-qualified withdrawals are those made other than for a qualified purpose and, under current law, are subject to federal income tax to the extent of the earnings (accrued net investment income and gains) portion of the withdrawal. Georgia, under current law, conforms to the federal treatment of non-qualified withdrawals, including the earnings portion in state taxable income.

As of mid-year 2019, total 529 Plan accounts nationally numbered approximately 14 million, with plan assets of $352 billion, according to savingforcollege.com. The average account balance at that time was $25,615. As of September 30, 2020, GHESP reported plan assets of $3.582 billion in 188,271 accounts, for an average asset balance of $19,027. Withdrawals from GHESP accounts (qualified or non-qualified) in the year ended June 30, 2020, totaled $228.33 million.

In 2018, the latest year for which non-qualified withdrawal data are available, total non-qualified withdrawals from GHESP accounts was approximately $9.72 million, attributable to 1,672 accounts for an average non-qualified withdrawal amount of $5,815. About $8.47 million or 87 percent of withdrawals were attributable to Georgia account holders, the balance to account holders residing in other states. It is not clear how much of these withdrawals represent account earnings that would be taxable under current law.

Approximately 40 million U.S. households in 2020 include the householder’s own children under age 25, according to U.S. Census Bureau data. An additional 10 million households with no own children are headed by a householder between the ages of 20 and 29. These 50 million households represent the likely universe of 529 Plan owner or beneficiary households.

The 14 million total 529 Plan accounts nationwide represents about 28% of likely owner/beneficiary households, though it is likely many account owners have accounts for more than one child beneficiary. According to savingforcollege.com, just under 18 percent of children under age 18 are beneficiaries of 529 Plan accounts.

Assuming a similar percentage of first-time military enlistees are 529 Plan beneficiaries, one can estimate the potential number of enlistees from Georgia that could benefit from the proposed bill, withdrawing 529 Plan balances that would be excluded from state tax. Over federal fiscal years 2016-18, average annual non-prior service enlistees from Georgia into active duty U.S. military was 6,915. If 18% of those enlistees are beneficiaries of 529 Plan accounts and all such accounts are in GHESP (as opposed to another state’s plan), then as many as 1,245 enlistees per year, on average, may decide to withdraw funds from their accounts for non-qualified purposes under current law and that would qualify as enlistment withdrawals under the proposed law.

Assuming all such enlistees make withdrawals equal to the average non-qualified withdrawal in Georgia in 2018 ($5,815), total withdrawals would be approximately $7.24 million. If account assets equal, on average, the state average balance of $19,027 and entire balances are withdrawn, the total would be $23.69 million. An unknown portion of these amounts would represent account earnings, the portion taxable under current law, but assuming half of the amounts withdrawn represent earnings, then the taxable totals would be $3.62 and $11.85 million, respectively.

The next unknown is whether the account owner or the beneficiary is making the withdrawal and thus owes the tax. If the owner, the effective marginal tax rate on that income is likely to be at or near the top state rate of 5.75 percent, resulting in tax of $208 to $681 thousand, depending on the average withdrawal scenario. If the beneficiary reports the income, however, the effective tax rate of a new military enlistee is likely to be materially lower.

There are, of course, various reasons to suspect new enlistees with 529 plan accounts not to respond to the proposed tax change by making substantial withdrawals upon enlistment, including but not limited to the fact of federal taxes and penalties (the latter at 10 percent of the earnings withdrawn), and the possibility that the enlistee may plan or consider attending college after their initial term of military service.

All these factors (and known unknowns) considered, while it is not possible to make a meaningfully informed estimate of the likely revenue cost, it seems reasonable to conclude that such cost is unlikely to exceed $1 million per year.