



COLORADO

Department of Revenue

529 Plans Fact Sheet

Deductibility of K-12 Contributions to 529 Accounts in Colorado

March 5, 2018

Current:

Under Colorado law (39-22-104(4)(i), C.R.S.), a donor is entitled to a subtraction from federal taxable income equal to the amount contributed to a qualified state tuition program (529 Plan). Any distribution from a 529 Plan must be used for post-secondary education costs. If an account holder makes a distribution from a 529 account for a non-qualified expense, the amount of the non-qualified expense is subject to recapture, in the amount of the tax owed, from any donor who took a contribution subtraction for their contribution to the 529 plan.

Federal Change:

Public Law No. 115-97, also known as the Tax Cuts and Jobs Act (Act), signed into law in December 2017, changed federal law in Section 529(c) of the Internal Revenue Code (IRC) to expand the qualified use of 529 plans to include K-12 tuition and other expenses, limited to \$10,000 per year, per beneficiary across all qualified tuition programs.

Ambiguity in Law:

Colorado law currently defines qualified expenses (for purposes of the recapture) by referencing Section 529(e)(3) of the IRC. The Act, allowing for K-12 expenses, was not included in the part of the federal law that Colorado law references; however, the definition of qualified expenses was changed in an alternate paragraph (Section 529(c)(7)). The statutory provisions that govern the Colorado qualified state tuition program (CollegInvest), reference Section 529 generally (see 23-3.1-302 & 309) and therefore may incorporate the federal changes. Thus, it is ambiguous if the Colorado Department of Revenue (CDOR) should or should not follow the federal change and allow for subtraction of K-12 expenses on a Colorado income tax return.

CDOR consulted with the Colorado Attorney General's Office (AG) and has been advised that the intent of the federal law appears to broaden the definition of qualified expenses throughout Section 529 but was drafted ambiguously, and thus CDOR could reasonably allow deductions of K-12 expenses, without recapture. This interpretation would also reduce confusion amongst taxpayers between federal and Colorado law.

The Office of Legislative Legal Services (OLLS) also conducted an analysis and concluded that with a more narrow reading of the statute, CDOR would be required to allow the contribution subtraction under current statute, but would be required to recapture any distribution for K-12 expenses due to the pinpoint citation in the recapture provision of Colorado statute. If CDOR does not conform with the federal change in the definition for qualified expense, Colorado taxpayers will be allowed a subtraction for contributions to a 529 Plan, however, CDOR would be required to recapture from the donor taxes owed on any distribution used by the account owner



to pay for K-12 expenses at the time of the distribution, which could be years later. CDOR's expenditures to enforce the recapture provisions would increase due to the statutory inconsistency between federal and Colorado law.

Definitions:

- **529 Plan:** A tax-advantaged savings plan designed to encourage saving for future college costs. Legally known as "qualified tuition plans," are sponsored by states, state agencies, or educational institutions and are authorized by Section 529 of the Internal Revenue Code. Earnings on distributions used for qualified expenses are not taxed on the federal or state level.
- **Account Holder:** The person in charge of the 529 plan with the ability to access and administer funds.
- **Beneficiary:** The person receiving the benefit of the 529 plan, i.e., the student.
- **Donor:** Anyone can donate to a 529 plan. A donor is typically a parent, but it can also be a relative, employer, friend, and etc...
- **Qualified Expense:** Allowable reasons (tuition, fees, room and board, supplies, computers and internet access, etc...) to distribute from a 529 account.

Issue:

If both HB18-1221 and HB18-1209 fail, CDOR will seek further legal guidance and be forced to make a determination on whether or not to allow contribution subtractions for K-12 tuition expenses.

Position:

Due to the ambiguity in the federal changes, CDOR seeks guidance from the Colorado General Assembly as to whether to de-couple from the federal law or follow suite and allow K-12 expenses for 529 plans.