

THE WALL STREET JOURNAL.

STATES WORRY YOU MAY CLAIM 529 TAX EXEMPTION FOR K-12 SCHOOL TUITION

Officials fear big hit to tax revenues by letting more parents use the savings plans for education costs

By Michelle Hackman
February 16, 2018

State officials across the country are increasingly worried that a provision in the new tax law extending college savings accounts to K-12 expenses will blow an unexpected hole in their budgets.

The federal government created modern 529 savings plans in the mid-1990s that allow families to put away money for education and allow it to grow tax-free. As an added incentive, more than 30 states offer their own tax breaks to people who put money into the accounts.

In December, as part of a broad tax overhaul, Congress expanded the accounts to cover up to \$10,000 a year in expenses for kindergarten through 12th grade.

State budget officials are now concerned that a large number of parents will use 529 accounts to pay private-school tuition, giving them a new write-off for their state taxes.

That could result in potentially millions of dollars in lost tax revenue at a time when most states are struggling to close budget deficits.

"I'm worried that families could use these accounts to avoid paying state taxes," said Illinois state treasurer Mike Frerichs, a Democrat. "This is only going to put a deeper hole in the budget."

The dispute is in part between state and federal officials, but it also often breaks down along party lines. Many Republicans favor tax breaks for families who send children to private or religious schools, which they see as a way to help parents, while Democrats worry that such breaks subsidize wealthy people and exclusive schools.

The expansion of 529 savings accounts, added to the tax bill at the last moment through an amendment from Sen. Ted Cruz (R., Texas), was a victory for advocates of private-school choice, who have struggled to push through other priorities such as a national voucher program.

Fifty senators voted against Mr. Cruz's amendment, including two Republicans, forcing Vice President Mike Pence to break the tie in favor of the measure. Opponents of the policy view the expansion as a backdoor way of creating a voucher system, as it directs public resources toward private, often religious schools.

The Cruz provision is projected to cost the federal government \$500 million over nearly a decade, but it could cost the states much more, research suggests. Across the country,

about 6.3 million children attended private elementary or secondary schools in 2017, compared with 52 million children enrolled in public schools.

Some critics say the GOP-led Congress is essentially imposing a social policy on the states – a criticism Republicans have frequently directed at Democrats.

“It’s not federalist at all,” said Nat Malkus, deputy director of education policy at the American Enterprise Institute, a center-right think tank. “I don’t think that the federal government should be cavalierly making problems for states by messing with state taxes.”

Some proponents of expanding tax benefits to private schools, including Education Secretary Betsy DeVos, also say the Cruz approach isn’t the most efficient, since it will primarily benefit wealthier families who can already afford to send their children to private schools.

“It’s a step in the right direction,” Mrs. DeVos told reporters in December. “But it doesn’t address the needs of parents who are from lower incomes, and does not empower them in significant ways.”

Some red states have embraced the change. In Missouri, state officials have launched a social-media campaign to tell residents they can use 529 accounts, and the state’s \$8,000-a-person tax deduction, for primary and secondary school expenses.

“Anything we can do to make education more affordable and let people save more of their own money is a good thing in my book,” said Missouri’s state treasurer, Eric Schmitt, a Republican.

Other states are expressing concern, some more publicly than others. In Indiana, where the state offers a \$1,000 tax credit to anyone putting money in a 529 account, the state could lose \$117 million a year, according to an estimate from Mr. Malkus. Pennsylvania could stand to lose \$92 million.

New York is one of eight to specify that its education tax breaks go solely for college expenses. But pressure is growing on state officials from some parents and lawmakers to open up the state’s \$10,000 tax deduction to private K-12 expenses.

Some state officials fear that if they take that step, parents of the 465,000 New York children enrolled in private schools could simply deposit money intended for tuition into a 529 account and withdraw the money days later, rather than letting the money accrue over time to use for college expenses. The change could cost New York \$120 million a year, according to Mr. Malkus’s estimate.

The New York State Division of the Budget didn’t respond to a request for comment.

Some states contend Mr. Malkus’s estimates of their potential tax losses are high, but he stands by his work.

In several other states that don’t automatically extend tax benefits in accordance with the new federal law, state lawmakers have proposed legislation to do so. So far this year, bills have been proposed in Wisconsin, Alabama, Illinois and Iowa, among others.

Iowa's state treasurer, Mike Fitzgerald, a Democrat, said he has concerns about his state's bill, but added that publicity around the federal changes is creating political pressure. "The press is telling everyone, 'Look at this sweetheart deal you've got now,'" he said.