How Will Expanded Use of 529 Accounts Affect Missouri's Budget?

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The federal tax reform bill is likely to have many consequences, intended and unintended. One intended consequence is that it expands the use of funds in 529 education savings accounts beyond college expenses to K-12 expenses. If parents open these accounts for their children and add money to them, they can withdraw those funds when needed for education expenses without paying taxes on what the savings have earned. In addition, in states that allow it, deposits to these accounts can be deducted from income on state forms, thereby lowering the tax bills of savers.

The St. Louis Post Dispatch cited an analysis of the impact this change could have on state coffers which found that Missouri tax revenue could drop by as much as $42 million dollars once all private school parents open these accounts and route their child’s tuition through them in order to reduce their state taxable income. That amount is dramatically higher than the likely reality, because it depends on several conditions being met.

First, every current private school student would suddenly have to have one of these accounts with enough funds to cover tuition. Second, in order to take the maximum deduction, all private school students would need to have married parents who file their taxes jointly. And third, all of those parents would need to have a marginal tax rate that is higher than the average for the state.
It is more likely that the impact would be about $32 million. We get this by multiplying the number of students enrolled in private elementary schools in Missouri by the average private elementary school tuition in Missouri ($6,800) and most (75 percent) private high school students by the average high school tuition of $11,500, with the remaining 25 percent of students taking the maximum benefit allowed for a single filer in Missouri of $8,000. Further, we use the average marginal tax rate in the state, which is 3.6 percent.

And while it is unlikely that a tax break of $500 or so would be enough to induce public school parents to switch to private schools, any who did would essentially save the state money. They would pay $500 less on their tax bill, but their child’s education bill would no longer be paid for with public dollars.

It makes sense to try to anticipate the impact of federal tax reform on state tax revenue, but it needs to be done in a sensible way.

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