SFA BILL ANALYSIS
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Senate Bills 433, 434, and 435 (as passed by the Senate)
Sponsor: Senator Doug Carl (S.B. 433 and 434)
Senator Jack Welborn (S.B. 435)
Committee: Finance

Date Completed: 8-30-89

RATIONALE

In his 1986 State of the State address, Governor Blanchard said that he shared "the deep concern of parents of young children, who fear that they cannot honestly promise their children the hope of a higher education at a Michigan public college or university". In response to the predicted ever-widening gap between the cost of a college education and the ability of Michigan families to meet that cost, a gap exacerbated by increasing tuition costs and a declining Federal commitment to student financial aid, the Governor proposed the creation of a guaranteed tuition program. As a result, the Michigan Education Trust (MET) was created to allow a person to enter into a contract with the MET that guarantees, in exchange for a lump sum payment when the contract is entered into, the tuition of a qualified beneficiary when the beneficiary attends college in the future. Over 40,000 applicants enrolled in the MET program the first year it was offered.

While it appears that the MET program has thus far been successful, it has two aspects that limit participation: 1) entry into the program is offered for a limited time period, and only when the MET Board decides to open an enrollment period; and 2) the program demands a lump-sum payment for participation, which means that, for each of their children, enrollees must generally borrow the money to make the payment, or take money from their savings. It has been suggested that the State should offer an alternative to the program, one that would encourage parents to save money to send their children to college. Some people feel that parents could make substantial contributions toward the cost of a college education if the State allowed parents to put money into a tax-exempt "tuition savings account", in much the same way that the Federal government allowed persons to put money into individual retirement accounts.

CONTENT

The bills would amend the Income Tax Act to allow parents or guardians to establish "tuition savings accounts" for their children and to deduct from taxable income up to $2,000 in contributions to an account; and to provide that income earned by an account and interest paid on a loan that was used as a contribution to an account would be exempt from taxation. Senate Bills 433 and 434 are tie-barred to Senate Bill 435.

Senate Bill 435 would define a "tuition savings account" as a trust account established under State laws by a parent or guardian who named his or her child as beneficiary, and that was controlled by a trust instrument that prescribed and was administered to comply with the following:

-- Principal and income from the trust were used exclusively for payment of the child's tuition or room and board, or both, at an in-State institution of higher education, a private degree-granting college or university, or a community or junior college.
-- The trust was dissolved no later than the beneficiary's 25th birthday.

S.B. 433-435 (8-30-89)

- If the trust were dissolved on the beneficiary's 25th birthday, the balance remaining in the trust account would be considered income to the beneficiary in the tax year in which the account was dissolved. If dissolved before the beneficiary's 25th birthday, the balance would be considered income to the parents or guardian of the beneficiary in the tax year in which the trust was dissolved.
- The trust account was established for a single beneficiary and was the only trust account established for that beneficiary that was being used to qualify for the tax exemption allowed for a tuition savings account.

The bill would exempt from the income tax income earned by a tuition savings account.

Senate Bill 433 would allow a taxpayer to deduct from taxable income, to the extent included in Federal adjusted gross income, the amount of interest paid on a loan that was used as a contribution to a tuition savings account.

Senate Bill 434 would allow a taxpayer to deduct from taxable income the amount of a contribution the taxpayer made to a tuition savings account. A taxpayer could not deduct more than $2,000 per year per account.

MCL 206.30 (S.B. 433 and 434)
Proposed MCL 206.38 and 206.92 (S.B. 435)

FISCAL IMPACT

Senate Bills 433-435 would lead to an indeterminate reduction in GF/GP income taxes and a reduction in revenue sharing payments to local units. The reduction in tax revenue would depend on the number of tuition savings accounts established.

ARGUMENTS

Supporting Argument

Establishment of the MET program was a unique, first-in-the-nation attempt that aimed to increase access to higher education by allowing parents to pay their children's college tuition in advance and guaranteeing them that the payments would cover the cost of undergraduate tuition at a college, no matter what happened later to tuition rates. While government officials were overjoyed with the 40,000-plus first-year enrollees, saying that the number far exceeded their predictions, it must be pointed out that the number represents a small percentage of the State's young people who are someday expected to attend college. For any number of reasons (for instance, cost, limited enrollment period, fear that the trust may not remain financially sound, hesitation at dedicating a substantial sum of money for a lengthy period of time--in some cases up to 18 years, and belief that other investments may offer a better return than the MET), it is clear that the MET is not for everyone. The bill, by allowing for the tax-exempt deposit of up to $2,000 per year per account, would offer an attractive alternative to the MET that would encourage parents to save money for their children's college education. Tuition savings accounts would, in effect, encourage savings for education in much the same way that individual retirement accounts (IRAs) have encouraged persons to save for their retirement.

Supporting Argument

The establishment of tuition savings accounts could have many of the same beneficial effects that have been predicted for the MET program. For instance, students would be freer to choose a college based on their needs, interests, and talents rather than on financial considerations, and in turn could be more academically motivated both in high school preparation and the college of their choice. Students and their families could be spared some portion of the debt that graduates often encourage and that can, if substantial, alter career choices. Further, students whose families were unable to pay for college costs, the MET program, or the tuition savings program offered by the bills, could be able to find larger amounts of student aid available because there would be fewer students competing for the aid.

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Senate Bill 434

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See SB 433

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