Legislative Analysis

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REVISE EDUCATION SAVINGS FUNDS

House Bill 4202 (reported without amendment)
Sponsor: Rep. Steven Lindberg
Committee: Education

First Analysis (10-26-09)

BRIEF SUMMARY: The bill would revise the rules for creating Michigan Education Savings Funds, to allow governmental entities and corporations to be account owners; to permit scholarship programs to defer naming beneficiaries; and to add electronic funds transfer as a method of disbursing the funds.

FISCAL IMPACT: The fiscal impact of this bill depends on the additional number of accounts that would be set up and the contributions to these accounts. Under current law, contributions to these accounts up to $5,000 for single and $10,000 for joint returns are not subject to the income tax. This bill would reduce income tax revenue, which would affect General Fund/General Purpose and School Aid Fund revenue. This bill would have no direct affect on local units of government.

The Treasury Department would not realize any fiscal impact from the bill.

THE APPARENT PROBLEM:

Section 529 plans, also known as Qualified Tuition Programs, are set up to save for a child's college education. There are two types of Section 529 plans—prepaid tuition plans such as the Michigan Education Trust (MET) and college savings plans (such as the Michigan Education Savings Program). Both are named after Section 529 of the U. S. Internal Revenue Code, which specifies the requirements for the plans so that they remain free from federal income taxes.

Prepaid tuition plans let you lock in future tuition rates at in-state public colleges at current prices and are usually guaranteed by the state. College savings plans are more flexible, allowing you to invest more money and paying out to colleges countrywide. However, the savings plans do not offer a guarantee to cover tuition and other university-related costs.

Section 529 college savings plans are tax-exempt college savings accounts which have little negative affect on a student's eligibility for need-based financial aid. Unlike prepaid tuition plans, there is no lock on tuition rates and no guarantee. Investments are subject to market conditions, and the savings may not be sufficient to cover all college costs. However, with this added risk comes the potential for greater returns.

Customarily a beneficiary is named when a college savings plan is set up by parents, grandparents, or in some instances by nonprofit charitable organizations. According to a spokesperson from the Michigan Department of Treasury, the U.S. Internal Revenue

Code now allows governmental entities and corporations to set up tax-exempt scholarship programs. Further, governmental entities, corporations, and nonprofit organizations are able to defer naming their designated beneficiaries when they establish their scholarship programs. Legislation has been introduced to achieve those ends in Michigan's statute.

THE CONTENT OF THE BILL:

The bill would amend the Michigan Education Savings Program Act to allow governmental entities and corporations to be account owners, to allow scholarship programs to defer naming beneficiaries, and to add electronic funds transfer as a method of disbursing Michigan Education Savings Funds.

Currently under the law, an "account owner" is defined to mean either

(1) the individual who enters into a Michigan Education Savings Program agreement and establishes an Education Savings Account. The account owner may also be the designated beneficiary of the account; or

(2) an entity exempt from taxation under Section 501(c)(3) of the Internal Revenue Code or an estate or trust that enters into a Michigan Education Savings Program agreement and establishes an Education Savings Account.

House Bill 4202 would expand this second definition of "account owner" to include ***a state or local government agency or instrumentality, or a corporation***, in addition to a nonprofits and estates and trusts.

Under the law, an entity or individual who enters into a Michigan Education Savings Program agreement completes a form that has been prescribed by a program manager and approved by the state treasurer. The law specifies the information that must be included on the form, including a designated beneficiary. House Bill 4202 retains these provisions, but adds that as part of a scholarship program, a state or local government entity, a 501(c)(3) nonprofit, or a corporation, could ***defer naming a designated beneficiary*** consistent with the terms of the applicable MESP agreement.

The law also requires that contributions to accounts be made in cash, by check, by money order, by credit card, or by any similar method as approved by the state treasurer, but shall not be property. House Bill 4202 would eliminate "by money order."

Finally, the law describes how and to whom distributions from an account can be made. Specifically, distributions may be made directly to an eligible education institution; or in the form of a check payable to both the designated beneficiary and the eligible education institution; or in the form of a check payable to the designated beneficiary or account holder. House Bill 4202 would retain these provisions and add a fourth option: ***in the form of an electronic funds transfer to an account specified by the designated beneficiary or account holder***.

MCL 390.1472 and 1477

BACKGROUND INFORMATION:

For further information about Michigan's Education Savings Program located in the Department of Treasury, visit: www.misaves.com

Two websites (of many) with useful information on Section 529 plans are: www.savingforcollege.com and finaid.org

ARGUMENTS:

For:

According to the Department of Treasury, Michigan has one of the lowest cost college savings programs in the country. To take advantage of the tax-deferred program—by investing either in the prepaid MET Plan or in the MESP Plan—Michigan residents can contact the Department of Treasury themselves and arrange to join. No broker or financial advisor is necessary; a citizen need simply take the initiative.

Customarily, college savings plans are established by nonprofit charitable organizations, or by parents or grandparents, and when they are set-up their beneficiaries are named. However, recent changes in the U. S. Internal Revenue Code now allow college savings plans to also be set-up by governmental entities and corporations. This legislation would update Michigan's statute to do the same. In addition, the bill would allow these groups and nonprofit organizations who create scholarship programs to defer naming the beneficiaries of the plans they establish.

Finally, the bill would modernize the manner in which funds from the accounts can be distributed in order to include electronic funds transfers.

POSITIONS:

The Department of Treasury supports the bill. (10-22-09)

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