Legislative Analysis

Mitchell Bean, Director
Phone: (517) 373-8080
http://www.house.mi.gov/hfa

EDUCATION SAVINGS PROGRAM AMENDMENTS

House Bill 5534 (Substitute H-1)
House Bill 5782 as introduced

Sponsor: Rep. Gene DeRossett
Committee: Tax Policy
First Analysis (6-4-04)

BRIEF SUMMARY: House Bill 5534 would allow MESP account owners to claim a deduction even after they make a withdrawal from an MESP account. House Bill 5782 would make several amendments to the MESP Act, including allowing estates and trust to act as account owners and increasing the transferability of account funds.

FISCAL IMPACT: House Bill 5534 would reduce income tax revenue by a minimal amount. House Bill 5782 would have no significant fiscal impact on state or local government.

THE APPARENT PROBLEM:

Public Act 161 of 2000 created the Michigan Education Savings Program Act, under which individuals can contribute money to special accounts with the proceeds to be used to pay higher education expenses, including tuition, fees, books, supplies, equipment, and room and board. The maximum account balance for all accounts for any one beneficiary is $235,000. Contributions to an education savings account are deductible, up to certain specified amounts, in determining state taxable income. With more than 60,000 account owners, 116,000 accounts, and $600 million in assets, the MESP is generally successful. Nevertheless, it has been suggested that the MESP Act could be amended so as to expand account access and facilitate participation in the program.

THE CONTENT OF THE BILL:

House Bill 5534 - Deductibility of Contributions

Under the Income Tax Act, a contribution to an education savings account can be deducted (to the extent that the contribution has not already been deducted in determining federal adjusted gross income) when determining state taxable income. The amount of the deduction is limited to $5,000 for a single return and $10,000 for a joint return. House Bill 5534 would delete a provision in the Income Tax Act that disallows the deduction once a withdrawal (qualified or non-qualified) has been made from the education savings account, and would add that deduction would be the amount contributed less any *qualified* withdrawals made in the tax year (subject to the $5,000/$10,000 cap).

In addition, the Income Tax Act provides that amount of any non-qualified withdrawal must be added to the federal adjusted gross income (to the extent that it is not already included) when determining state taxable income. The bill would specify, however, that the addition to AGI could not exceed the total amount of contributions (less qualified withdrawals) deducted from federal AGI in the tax year and all previous tax years. The bill also specifies that the above provision (adding non-qualified withdrawals to AGI) would not apply to withdrawals that were less than the sum of all contributions made to an education savings account in all previous tax years for which no deduction was claimed (less any withdrawn contributions for which no deduction was claimed in all previous tax years).

MCL 206.30

House Bill 5782 - Michigan Education Savings Program Act Amendments

The bill would make the following amendments to the Michigan Education Savings Program Act:

** Under the act, individuals and 501(c)(3) tax exempt organizations can enter into a education savings program agreement establishing an account, and become an "account owner". The bill would also permit estates and trusts to serve as account owners.

** In addition, the bill would require requests for distributions from an account be on a form approved by the state treasurer. The bill would also permit the program manager (TIAA-CREF Tuition Financing, Inc.) to retain from the distribution the amount necessary to comply with state and federal tax laws.

** Under the act, distributions are made in the following ways circumstances: (1): directly to an eligible educational institution; (2) in the form of a check payable to both the beneficiary and the educational institution; (3) as reimbursement for educational expenses already paid, with the necessary documentation submitted; and (4) if the beneficiary certified that the distribution was to be spent for educational expenses within 30 days and the account retained a balance large enough to collect any penalty owed if valid documentation of the payment was not subsequently produced. The bill would delete (3) and (4) and, instead, permit distributions be made in the form of a check to beneficiaries or account owners without any other conditions.

** Finally, the bill would permit an account owner to transfer all or a portion of an account to an individual or eligible entity [that is, a 501(c)(3) tax exempt organization, an estate, or a trust].

MCL 390.1472 et al.

BACKGROUND INFORMATION:

Under the Michigan Education Savings Plan Program, the state matches $1 for every $3 in contributions for certain beneficiaries. The matching grant is capped at $200 per eligible beneficiary and is only available in the first year the beneficiary is enrolled in the program. In order to receive the matching grant, the beneficiary must be a state resident and no more than six years old, and the beneficiary's parents must have a federal adjusted gross income of not more than $80,000.

ARGUMENTS:

For:

House Bill 5534 would permit a taxpayer to claim a deduction for a MESP contribution even after making a withdrawal from the account. The current provision disallowing a deduction greatly penalizes taxpayers. These MESP accounts are intended to meet the long-range goals for taxpayers and their children. However, as life circumstances change, situations can occur that prompt taxpayers to prematurely withdraw money from the MESP. There may an instance where a family is facing a financial emergency that requires them to withdraw money from the MESP. Once that withdrawal occurs, the taxpayer can no longer ever claim a deduction for an MESP contribution. This provision, then, really becomes a major disincentive to contribute to the program once funds have been withdrawn. In addition, by "netting" the deduction (contributions less qualified withdrawals), the bill ensures that a taxpayer doesn't contribute money to the MESP, claim the deduction, and then use that money for higher education expenses. For instance, absent the "net" provision, a taxpayer could contribute $10,000 to an MESP account, receive a tax break of $390 (by deducting $10,000 from their federal adjusted gross income), and use the $10,000 contribution (which really costs $9,610) for higher education expenses.

For:

House Bill 5782 makes numerous smaller amendments designed to facilitate participation in the program. First, it permits estates or trusts to become account owners, something that is currently permitted under Michigan Education Trust (MET) program. This provides certain tax advantages to estates and, again, allows for greater participation in the MESP program. This option is also available in numerous other states.

In addition, the bill allows account owners to transfer all or a portion of an account to other individuals or eligible entities. Under current law, accounts can be transferred to another account owner only upon the death of the current owner. Allowing a transfer of ownership for any reason provides owners with greater flexibility in assuring that benefits will be provided to students, as situations may arise where it becomes necessary to transfer account ownership, perhaps from a beneficiary's grandparent to parent. This is also already permitted under the Michigan Education Trust.

POSITIONS:

The Department of Treasury supports the bill. (6-2-04)

TIAA-CREF supports the bill. (6-2-04)

Legislative Analyst: Mark Wolf
Fiscal Analysts: Kyle Jen
Rebecca Ross

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