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BILL ANALYSIS

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House Bill 5534 (Substitute H-1 as passed by the House)
Sponsor: Representative Gene DeRossett
House Committee: Tax Policy
Senate Committee: Finance

Date Completed: 8-4-04

CONTENT

The bill would amend the Income Tax Act to allow a person who had an education savings account created under the Michigan Education Savings Program (MESP) Act to continue to claim a State income tax deduction for contributions made after a withdrawal from the account.

Under the Income Tax Act, "taxable income" means a person's adjusted gross income, as defined in the Internal Revenue Code, subject to certain adjustments. The Act allows a deduction for the total of all contributions made to MESP accounts in a tax year, up to $5,000 for a single return or $10,000 for a joint return; interest earned on contributions to MESP accounts; and distributions from MESP accounts that are "qualified withdrawals" under the MESP Act. ("Qualified withdrawal" means a distribution, not subject to penalty or tax, that is for a qualified higher education expense or a transfer allowed under the MESP Act or is a withdrawal made because of the designated beneficiary's death or disability or because the beneficiary received a scholarship for all or part of the qualified higher education expenses.) Under the bill, a taxpayer could deduct the total of all contributions made to an MESP account in a tax year, less qualified withdrawals made during the tax year. The bill would delete a provision under which a deduction is not allowed for the tax year in which the initial withdrawal is made or any subsequent year.

Under the Income Tax Act, the amount withdrawn in a tax year from an MESP account must be added to a taxpayer's adjusted gross income if the withdrawal is not a qualified withdrawal under the MESP Act. Under the bill, the amount required to be added to adjusted gross income under that provision could not exceed the total amount the taxpayer deducted for MESP contributions, interest earned on contributions, and qualified withdrawals. Currently, there is no cap on the amount added to a taxpayer's adjusted gross income.

In addition, under the bill, the requirement that MESP withdrawals that were not qualified withdrawals be added to a taxpayer's adjusted gross income 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 contributions for which no deduction was claimed that were withdrawn in previous tax years.

MCL 206.30 Legislative Analyst: J.P. Finet

FISCAL IMPACT

Of the $697.5 million currently in the 118,325 MESP accounts, only about $10,000 was withdrawn during the past year. As a result, it is estimated that the bill essentially would have no fiscal impact on State income tax revenue at the present time. In addition, the bill would have no direct impact on local governments.

Fiscal Analyst: Jay Wortley