

Senate Fiscal Agency
P. O. Box 30036
Lansing, Michigan 48909-7536

SFA

BILL ANALYSIS

Telephone: (517) 373-5383
Fax: (517) 373-1986
TDD: (517) 373-0543

House Bill 5317 (Substitute H-3 as passed by the House)
Sponsor: Representative Gene DeRossett
House Committee: Commerce
Senate Committee: Finance

Date Completed: 12-4-01

CONTENT

The bill would amend the Michigan Education Savings Program Act to do the following:

- Provide that unqualified withdrawals from an education savings account would not be subject to a State penalty, if a Federal penalty or tax were imposed on the withdrawal.**
- Revise the basis for the current State penalty.**
- Allow certain charitable entities to open an education savings account.**
- Allow an individual account owner to select investment strategies once per year.**

The bill would take effect January 1, 2002.

The Act allows individuals to enter into a Michigan education savings program agreement and establish an education savings program account; the account proceeds are to be used to pay for a designated beneficiary's higher education expenses. The Act contains a list of reasons that money may be withdrawn from an account; these are considered qualified withdrawals, that is, not subject to penalties or taxes under the Act or the Income Tax Act. (Contributions to and interest earned on an account, and qualified withdrawals from an account, are deductible under the Income Tax Act.)

Currently, an unqualified withdrawal is subject to a penalty equal to 10% of the distribution, which must be paid to the State's General Fund. The bill provides that a distribution made after December 31, 2001, that was not a qualified withdrawal would not be subject to a penalty, if a penalty or tax were imposed on the distribution under Section 529 of the Internal Revenue Code (IRC), pursuant to Section 530(d)(4) of the Code. (Section 529 of the IRC allows states to establish education savings programs, under specified conditions, and exempts from Federal taxation certain contributions and distributions from an account. Under Section 530(d), distributions from an account are includable in Federal gross income unless they are for qualified higher education expenses. Section 530(d)(4) provides that the Federal tax imposed on any taxpayer who receives a distribution that is includable in Federal gross income must be increased by 10% of the amount that is includable.)

Under the bill, if a Federal tax or penalty were not imposed for a distribution that was not a qualified withdrawal, the program manager of the education savings program would have to withhold a penalty equal to 10% of the accumulated earnings attributable to the distribution amount (rather than 10% of the distribution amount), for payment to the State's General Fund.

The Act permits an education savings account to be established by an individual. The bill also would allow an entity exempt from Federal taxation under 501(c)(3) of the IRC to open an account. (A 501(c)(3) entity is a tax-exempt charitable organization that meets the requirements of that section.

The Act allows an individual who establishes an account to select among different investment strategies, but only at the time of the initial contribution establishing the account. The bill would allow an individual to select an investment strategy once each calendar year after the initial selection, to the extent allowed under the IRC.

Currently, the total contributions to all accounts that name one individual as the designated beneficiary may not exceed \$125,000. The bill provides instead that the maximum account balance of all the accounts naming one individual as the designated beneficiary could not exceed \$125,000.

MCL 390.1472

Legislative Analyst: G. Towne

FISCAL IMPACT

State Government. This bill would have a very minimal negative impact on General Fund revenue. Nonqualified withdrawals from education savings accounts have been extremely rare to-date. As a result, the revenue collected from the penalties assessed on these withdrawals, which would be eliminated under this bill, has so far netted the General Fund less than \$1,000.

Local Governments. The bill would have no fiscal impact on local government.

Fiscal Analyst: J. Wortley