Jana R. Vawter *Legislative Service Commission*

H.B. 427

123rd General Assembly
(As Introduced)

Reps. Kilbane, Householder, O'Brien, Clancy, Cates, Hood, Grendell, Goodman, Schuck, Van Vyven

BILL SUMMARY

- Establishes the Ohio Better Education Savings Trust Program (OBEST), a college savings program recognized as a tax-deferred investment program under federal taxation law and exempt from taxation under Ohio Income Taxation Law.

- Provides the Treasurer of State with rule-making authority for the administration and implementation of the OBEST program and specifies the duties of the Treasurer of State with respect to being the trustee and custodian of funds deposited under the program, contracting with investment agents for the investment of program funds, and establishing refund penalties.

- Provides that the Treasurer of State may charge administrative fees for participation in the OBEST program.

- Imposes a duty upon the Treasurer of State and investment agents of OBEST funds to act prudently with respect to the funds.

- Specifies the effect of participation in the OBEST program for Ohio income taxation purposes.

CONTENT AND OPERATION

The Ohio Better Education Savings Trust Program

(secs. 3334.20, 3334.21, and 3334.22(A), (C), and (F))

Under current law, a college savings program is established and administered by the Ohio Tuition Trust Authority and is referred to as the Ohio

College Savings Program (Chapter 3334.). The bill establishes an additional college savings program, the Ohio Better Education Savings Trust Program (OBEST).

The OBEST program is recognized as a tax-deferred investment program under federal taxation law, and participation in the program generally is exempt from Ohio income taxation. Specifically, under the bill, the OBEST program is specified as a qualified state tuition program under section 529 of the Internal Revenue Code and is administered by the Ohio Treasurer of State in accordance with the bill, the Internal Revenue Code, and regulations adopted by the Internal Revenue Service (IRS). Contributions and earnings under the OBEST program generally are not taxable under Ohio's Income Taxation Law (see "***Participation in the OBEST program under Ohio Income Taxation Law***," below). In addition, the bill provides that a person may contribute simultaneously to the OBEST program and to the Ohio College Savings program established in current law.

Under the bill, a person may make contributions to an account established under the OBEST program exclusively for the purpose of meeting the qualified higher education expenses of the designated beneficiary of the account. An investment agent, with which the Treasurer of State has contracted for the purpose, must invest the contributions in accordance with the bill's provisions, and contributions must be made in cash only (see "***Investment of funds***," below). In addition, interest in an account may not be used as security for a loan.

The bill also provides that participation in the program does not guarantee that contributions and earnings on contributions, if any, will be adequate to cover future qualified higher education expenses or that a designated beneficiary will be admitted to or permitted to continue to attend an eligible educational institution. And the bill specifies that Ohio has no debt or obligation to any contributor, designated beneficiary, or other person as a result of the establishment or administration of the program.

Definitions of "designated beneficiary," "qualified higher education expenses," "eligible educational institution," "eligible student," and "member of the family" mean the same as under section 529 of the "Internal Revenue Code of 1986" (see **COMMENT**, below).

Duties of the Treasurer of State under the OBEST program

(secs. 3334.22(B), (D), and (E), 3334.23, and 3334.24)

Fund trustee and custodian

The bill specifies that the Treasurer of State is the trustee of the OBEST program and custodian of contributions to program accounts and earnings on these contributions. The State Treasurer is to receive, hold, and oversee the investment of all contributions and earnings until they are disbursed to pay qualified higher education expenses or refunds. In addition, under the bill, the State Treasurer must ensure, as far as practicable, that contributions made on behalf of a designated beneficiary do not exceed an amount determined as specified by the bill. These amounts are to be determined by annually adjusted actuarial estimates that are necessary to provide for the beneficiary's qualified higher education expenses for five years of undergraduate enrollment at the highest cost eligible educational institution.

The bill provides that the State Treasurer must place all contributions and earnings in the OBEST program fund, which the bill creates. The fund is in the State Treasurer's custody but is not part of the state treasury.

Investment of funds

The bill requires the Treasurer of State to contract with one or more investment companies, insurance companies, or banks to (1) act as the Treasurer of State's investment agents, (2) invest contributions made under the OBEST program under guidelines established by and under the supervision of the State Treasurer, and (3) provide the services the Treasurer of State considers appropriate, including the purchase, control, and safekeeping of assets and record keeping and accounting for individual accounts and for the program as a whole.

The bill prohibits a contributor to or designated beneficiary of an account from directly or indirectly directing the investment of any contribution to the account or the earnings on the account.

General duty of State Treasurer and investment agents

The State Treasurer and any investment agents with which the State Treasurer contracts, under the bill, must discharge their duties with respect to OBEST program funds with the care and diligence that a prudent person familiar with such matters and with the character and aims of the program would use.

Refund penalties

The Treasurer of State must establish a penalty for any refund of earnings from the account that are not (1) used for qualified higher education expenses of the designated beneficiary, (2) made on account of the death or disability of the designated beneficiary, or (3) made on account of a scholarship or on account of an allowance or payment described in specified provisions of the Internal Revenue Code and received by the designated beneficiary to the extent the amount of the refund does not exceed the amount of the scholarship, allowance, or payment. The bill provides that the penalty amount established by the State Treasurer must not exceed the minimum penalty necessary to meet the requirements for a qualified state tuition program under the Internal Revenue Code.

Rule-making authority and administrative fees

The bill requires the Treasurer of State to adopt rules, under Ohio law not requiring public notice or hearing, for the implementation and administration of the OBEST program. The rules must provide taxpayers with the maximum tax advantages and flexibility with regard to (1) disposition of contributions and earnings, (2) designation of beneficiaries, and (3) rollover of account assets to other programs consistent with the bill's provisions and the Internal Revenue Code and regulations adopted by the IRS.

Under the bill, the Treasurer of State may charge administrative fees for participation in the OBEST program. However, these fees cannot exceed the minimum amount reasonably determined by the State Treasurer to be necessary to pay the costs of administration of the OBEST program.

Participation in the OBEST program under Ohio Income Taxation Law

(sec. 5747.01)

Currently, "adjusted gross income" is defined under Ohio Income Taxation Law as the adjusted gross income defined under the Internal Revenue Code with specified additions and deductions, including those relative to tuition credits purchased under the existing Ohio College Savings Program.

The bill provides that, in determining Ohio adjusted gross income, amounts should be *deducted* representing contributions to, and net investment earnings on, OBEST program accounts established under the bill's provisions. These amounts may be deducted to the extent not otherwise deducted or excluded for any taxable year from federal adjusted gross income. In addition, the bill specifies *adding* such previously deducted amounts to the extent that such amounts constitute distributions or refunds to the contributor during the taxable year from OBEST

program accounts established under the bill's provisions made for any reason other than (1) payment of qualified higher education expenses, (2) the designated beneficiary's death or disability, or (3) receipt of a scholarship, allowance, or payment described in the bill's provisions.

COMMENT

Qualified state tuition programs (QSTPs) are recognized as income tax deferral programs under federal taxation law. College savings programs, such as proposed by the bill, generally are referred to as "529 plans" based upon section 529 of the Internal Revenue Code. Under that section:

(1) "Designated beneficiary" generally means the individual designated as the beneficiary of amounts paid under a state tuition or scholarship program.

(2) "Qualified higher education expenses" means "tuition, fees, books, supplies, and equipment required for enrollment or attendance of a designated beneficiary at an eligible educational institution."

(3) "Eligible educational institution" generally means an institution described under the federal "Higher Education Act of 1965."

(4) "Eligible student," in part, is defined as a student who is carrying at least one-half the normal course load required for that student's course of study.

(5) "Member of the family" means a spouse or other individual who bears a specified relationship to the designated beneficiary.

HISTORY

ACTION	DATE	JOURNAL ENTRY
Introduced	08-19-99	p. 1190

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