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Bill Analysis
Legislative Service Commission

Sub. S.B. 161
123rd General Assembly
(As Passed by the Senate)

Sens. Gardner, Kearns, Schafrath, Shoemaker, Prentiss, Oelslager, Mumper, Cupp, Fingerhut, Spada, Nein, Drake, Latell, Watts, Hagan, Brady, DiDonato, White, Wachtmann, Armbruster, Latta

BILL SUMMARY

- Authorizes the Ohio Tuition Trust Authority to establish a Variable College Savings Program.
- Allows a tax deduction of up to \$2,000 per beneficiary for purchases of tuition credits and contributions to variable college savings program accounts.
- Provides for taxation of amounts previously deducted if such amounts are not distributed or refunded for specified purposes.
- Changes the method of calculating refunds of an existing college savings program account upon termination of the accounts in the case of death or permanent disability of the beneficiary.

CONTENT AND OPERATION

Background

Under current law, not changed by the bill, the Ohio Tuition Trust Authority operates a college savings program that allows a purchaser to acquire tuition credits under a tuition payment contract with the Authority. Under section 529 of the federal Internal Revenue Code, such programs receive favorable federal tax treatment for the programs' assets and distributions to beneficiaries if the program qualifies as a "qualified State tuition program." "Qualified State tuition program," under the federal law, means a program established and maintained by a state or agency or instrumentality thereof under which a person (1) may purchase tuition credits or certificates on behalf of a designated beneficiary that entitle the beneficiary to the waiver or payment of qualified higher education expenses of the

beneficiary (as under the existing state tuition credit program), or (2) may make contributions to an account that is established for the purpose of meeting the qualified higher education expenses of the designated beneficiary of the account (as authorized under the bill). The Ohio Tuition Trust Authority is authorized to operate as a qualified state tuition program within the meaning of section 529 of the Internal Revenue Code (R.C. 3334.03(A)--not in the bill).

Variable College Savings Program

Overview

The bill authorizes the Ohio Tuition Trust Authority to establish a Variable College Savings Program, which, if established, would supplement the existing college savings program. This new program would permit a person to contribute moneys to a savings investment account owned by the contributor but held in trust by and managed under the auspices of the state in benefit of another person.¹ A beneficiary may use the moneys from such account to pay college tuition and other higher education expenses at an "institution of higher education."² The account would be invested by the state or an agent of the state to provide a variable rate of return for the beneficiary. A contributor under the Variable College Savings Program may simultaneously participate as a purchaser in the existing college savings program.³

¹ R.C. 3334.02(C). *The bill defines "contributor" as "a person who signs a Variable College Savings Program contract with the Ohio Tuition Trust Authority and contributes to and owns the account created under the contract" (R.C. 3334.01(R)).*

² *For purposes of the newly authorized program, "beneficiary" is defined as "the individual whose tuition and other higher education expenses will be paid from a Variable College Savings Program account" (R.C. 3334.01(B)(2)).*

Existing law, unchanged by the bill, defines "institution of higher education" as a state institution of higher education, a private college, university, or other postsecondary institution located in Ohio that possesses either a certificate of authorization issued by the Ohio Board of Regents under R.C. Chapter 1713. or a certificate of registration issued by the State Board of Proprietary School Registration under R.C. Chapter 3332. "Institution of higher education" also includes any accredited college, university, or other postsecondary institution located outside Ohio. To be considered an "institution of higher education," an institution must meet the definition of an eligible educational institution under Section 529 of the Internal Revenue Code. (R.C. 3334.01(F).)

³ R.C. 3334.02(D). *As provided for under federal law, the new program, if established, would permit any individual, whether or not the individual is an Ohio resident, citizen, or taxpayer, to participate as a contributor or a beneficiary.*

Tax treatment

(R.C. 5741.01 and 5747.70; Section 3)

The bill creates a deduction from the personal income tax for purchases of tuition credits and contributions to variable college savings program accounts to the extent that the amount of such purchases and contributions are included in federal adjusted gross income. The deduction is limited to a combined aggregate of \$2,000 per beneficiary per year for the taxpayer and the taxpayer's spouse. Any excess may be carried forward to future years until the amount of the purchases and contributions is fully deducted.

If purchase or contribution amounts are distributed or refunded under a tuition payment or variable college savings program contract for any reason other than payment of higher education expenses or the beneficiary's death, disability, or receipt of a scholarship, the distributions or refunds are to be added to the recipient's adjusted gross income, to the extent (1) they are not already included in federal adjusted gross income, and (2) they were not required to be added back in a prior taxable year. If the distribution or refund is paid to someone other than the purchaser or contributor or beneficiary, which may be done pursuant to the contract, the requirement that the payment be added back in applies only to purchases and contributions made after the bill becomes law. (Since purchases made before the law were not deductible, they are not to be taxed upon refund.)

Existing law allows a deduction for income related to tuition credits that have not been refunded, to the extent included in federal adjusted gross income. This deduction is retained and expanded in the bill to include earnings on contributions to variable college savings program accounts. Existing law also allows a deduction for credits that have been refunded if the purchase price exceeds the amount of the refund, to the extent that the excess was not deducted from federal adjusted gross income. This deduction is retained in the bill, but only if no deduction was taken for the purchase or contribution. (This means, essentially, that this deduction remains available for credits purchased before the effective date of the new law; credits purchased after the effective date are deductible.)

Existing law requires that losses related to tuition credits be added to adjusted gross income to the extent they were deducted in determining federal adjusted gross income. The bill retains this requirement and expands it to include losses related to contributions made under the variable college savings program. Existing law requires that the amount of refunded credits be added to adjusted gross income to the extent not included in federal adjusted gross income. The bill eliminates this requirement.

The bill provides that its tax provisions apply to tax years beginning on and after January 1, 1999.

Administration of the program

(R.C. 3334.01, 3334.02, 3334.08, 3334.10, 3334.11, 3334.12, 3334.15, 3334.18, 3334.19, 3334.20, and 3334.21)

The Tuition Trust Authority is authorized to contract with a contributor to open and maintain investment accounts for one or more beneficiaries. The Authority must maintain a separate account for each variable college savings contract entered into for contributions made on behalf of a beneficiary, showing the name of the beneficiary of that contract and the amount of contributions made pursuant to that contract. As required under federal law, there must be one contract and one investment account under that contract for each beneficiary for whom the contributor plans to make contributions. The contract may permit a contributor to substitute a new beneficiary for the one for whom the contract was originally made.⁴ Participation in the program does not guarantee that the contributions, or any return on investment of the contributions, will be adequate to cover future college tuition and expenses of the beneficiary. Nor does participation guarantee that the beneficiary will be admitted to attend an institution of higher education. The bill expressly states that Ohio incurs no debt or obligation as a result of the establishment of the new program.⁵ Nevertheless, the Authority and any of its agents must exercise their duties "with the care and diligence that a prudent person familiar with such matters and with the character and aims of the program would use." In addition, the assets of the program must be preserved, invested, and expended solely for the purposes of the program and may not be used or loaned by Ohio for any other purpose. However, the bill specifies that it is not to be construed to prohibit the Authority or its investment agents from investing, by purchase or otherwise, in bonds, notes, or other obligations of Ohio or any Ohio agency or instrumentality. In addition, the bill provides that, unless otherwise specified by the Authority, assets of the program are to be expended in the following order of priority: (1) to make payments on behalf of beneficiaries, (2) to make refunds upon termination of variable college savings program contracts, and (3) to pay the costs of program administration and operations.⁶

⁴ R.C. 3334.08(A)(22), 3334.10(H), 3334.18(A), and 3334.19(B).

⁵ R.C. 3334.18(C).

⁶ R.C. 3334.19(F) and (G).

If the Authority establishes a Variable College Savings Program, the Authority must adopt an investment plan guiding the administration of the program. The Authority may manage the investment of the accounts opened under the program, or it may contract with insurance companies, banks, or other financial institutions to serve as its agents and to provide such services as the Authority considers appropriate to the investment plan. The bill specifies that these services may include: (1) purchase, control, and safekeeping of assets, (2) record keeping and accounting for individual accounts and for the program as a whole, and (3) provision of consolidated statements of account. Assets of the program may be invested in savings accounts, fixed or variable life insurance or annuity contracts, securities, evidences of indebtedness (including bonds, notes, or other obligations of Ohio or its instrumentalities), and other investment products in conformance with the investment plan. Contributors may not direct the investment of their contributions under the program. The bill also provides that if the Authority does not contract with an investment agent to invest variable college savings program funds, the Authority is the trustee of the program. In such event, the bill specifies that the Authority is to receive and hold all (1) payments, deposits, and contributions, (2) gifts, bequests, endowments, (3) federal, state, or local grants and any funds from any other source, public or private, and (4) all earnings, until disbursed to pay tuition or other higher education expenses or refunds pursuant to college savings plans contracts. In addition, the Authority must keep such funds segregated from all other assets of the Authority.⁷

As required under federal law, the Authority must "provide adequate safeguards to prevent" the combined contributions to the Variable College Savings Program account and purchases of tuition credits under the existing college savings program, from exceeding the amount necessary to pay tuition and other higher education expenses of the beneficiary.⁸ In addition, contributors and beneficiaries are entitled to request an annual statement of the contributions in each account.⁹ Any records of the program that indicate the identity of contributors or beneficiaries or amounts contributed to, earned by, or distributed

⁷ R.C. 3334.19(A), (C), (D), and (E).

⁸ R.C. 3334.18(B).

⁹ R.C. 3334.10(H). *The division restricts each contributor and each beneficiary to only one request per year. It is not clear whether each contributor or beneficiary can request one statement for each of their respective accounts annually or if they can request only one aggregate statement each year or both.*

from specific accounts are not public records for purposes of the Public Records Law.¹⁰

If the Authority does not contract with an agent for the management of the assets of the program, the bill specifies procedures that the Authority and the Treasurer of State must follow. Specifically, the bill establishes a new fund in the custody of the Treasurer but not in the state treasury to accept the assets of the program. The bill also provides that the Authority is the trustee of the fund and has full power to invest the moneys in the fund. However, until the Authority determines that it is financially and administratively feasible for the Authority to exercise its investment powers, the Public Employees Retirement Board must exercise those investment powers, with the approval of the Authority. The Authority also may contract with other entities to assist the Authority in the management of the assets. Other guidelines the Authority must follow in exercising its fiduciary responsibility with regard to funds received under the new program, its adoption of criteria, policies, and objectives for operating the program, and in buying, selling, and reporting on investments, parallel current requirements under the tuition credit program.¹¹

Rollovers from programs offered by other states

The bill permits the Authority to "impose limitations" on rollovers to plans offered by other states, but it does not outright prohibit such rollovers.¹²

Termination of contracts and refunds

The Authority may terminate any Variable College Savings Program contract if the contributor has not made any contributions to the account established under that contract for three years or more or if the amount of contributions are less than "an amount set by rule [of the Authority]."¹³

¹⁰ R.C. 3334.19(H). *The Public Records Law is codified in R.C. 149.43 (not in the bill).*

¹¹ R.C. 3334.20. *These procedures and guidelines do not apply if the Authority has contracted with an agent to directly manage the assets of the program. Such an agency is broader in scope than an agency established when the Authority manages the program itself and merely hires others to assist the Authority in carrying out its management duties.*

¹² R.C. 3334.08(A)(17).

¹³ R.C. 3334.08(A)(21).

The contributor may terminate any of the contributor's contracts with the Authority for any reason upon the contributor's written request to the Authority. No contract may be terminated, however, until the expiration of "a maturity period set by the Authority."¹⁴

If a contract is terminated because of the death or permanent disability of the beneficiary or "upon the rollover of the account to an equivalent account of another state," the bill provides that the contributor may receive a refund of the account balance less administrative fees. If the contract is terminated for any other reason, the contributor may receive a refund of the account balance less administrative fees *and less any additional amount necessary to meet the "minimum refund penalty"* as required under federal law. The Authority is required to determine the method and schedule for payment of refunds; earnings are to be calculated as the total value of the account less the aggregate contributions, or in such other manner as prescribed by section 529 of the Internal Revenue Code.¹⁵

Termination of the program

The bill provides that the Variable College Savings Program may be terminated by statute, or by the Authority if it determines that the program is not financially feasible. Upon termination of the program, all amounts held in program accounts must be returned to account owners to the extent possible. Any unclaimed assets must be deposited in the state's Unclaimed Funds Trust Account and distributed according to existing unclaimed funds law.¹⁶

Miscellaneous

The right to a tuition credit or a scholarship program, under existing law, or the right to funds of a Variable College Savings Program account may not be used as security or collateral for a loan.¹⁷

Current law, not changed by the bill, provides that the right to a tuition credit or a scholarship program is not subject to execution, attachment, garnishment, or operation of bankruptcy or insolvency laws. The bill adds that the

¹⁴ R.C. 3334.10(C).

¹⁵ R.C. 3334.10(D).

¹⁶ R.C. 3334.21.

¹⁷ R.C. 3334.15(B).

right to funds of a Variable College Savings Program account also are not subject to such actions.¹⁸

Change in refund policy under the existing tuition credit program

(R.C. 3334.10(B)(2)(a))

Under existing law, when a college savings program account is terminated because of death or permanent disability of the beneficiary of that account, the refund is to be the greater of:

- (1) One per cent of the weighted average tuition in the year the contact is terminated multiplied by the number of tuition credits purchased but not used; or
- (2) The total purchase price of the tuition credits purchased but not used.

The bill specifies that the weighted average tuition used to calculate the refund in paragraph (1) above is to be based on the year the "refund is paid." Thus, the owner of the account in such case would benefit from any increases in the tuition credit price from the time of termination of the contract to the time the refund is actually paid to the owner.

HISTORY

ACTION	DATE	JOURNAL ENTRY
Introduced	06-29-99	p. 827
Reported, S. Education	10-20-99	p. 1095
Passed Senate (33-0)	10-20-99	p. 1100

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¹⁸ R.C. 3334.15(A).