**HB 1121**

# Department of Legislative Services
Maryland General Assembly
1999 Session

## FISCAL NOTE

House Bill 1121 (Delegates Shriver and Taylor)
Appropriations

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**Maryland College Tuition Savings Plan**

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This bill establishes the Maryland College Tuition Savings Plan ("Savings Plan") to allow individuals to make contributions to an account established for the purposes of meeting the "qualified higher education expenses" of the "designated beneficiary" of the account.

The tax provisions of the bill apply to all taxable years beginning after December 31, 1998. The bill takes effect July 1, 1999.

## Fiscal Summary

**State Effect:** Indeterminate decrease in general fund revenues. Any increase in general fund expenditures for program start-up would be subsequently reimbursed by the Savings Plan.

**Local Effect:** Indeterminate decrease in revenues.

**Small Business Effect:** None.

## Fiscal Analysis

**Bill Summary:** The Savings Plan is to be administered and managed by the board of the Maryland Higher Education Investment Program (MHEIP), which must maintain the plan in compliance with Internal Revenue Service standards for qualified state tuition programs. A resident or nonresident may participate in and benefit from the plan.

The plan must reimburse the State for any start-up expenses paid by the State. The board shall select the vehicle for investments of the plan and its administration from among proposals submitted. The board shall require an initial application fee to be used for administrative costs of the plan. The board shall determine and make recommendations regarding the use of personnel in the State Treasurer's Office with costs for any administrative support from the State Treasurer's Office to be funded from the plan.

Contract benefits are not guaranteed in any way by the State. Neither the State nor any eligible educational institution shall be liable for any shortage of funds in the event that the accruals from the plan are insufficient to meet the tuition requirements of an institution chosen by the designated beneficiary. The assets and income of the plan are exempt from State and local taxation.

The Legislative Auditor shall audit the plan annually. The board shall pay for the audit. Within 90 days after the close of each fiscal year, the board shall submit a financial report of the plan to the Governor and General Assembly.

Purchasers may claim an income tax subtraction modification for the contributions made in that taxable year to the plan for each beneficiary. The subtraction may not exceed $2,500 per designated beneficiary for any taxable year. Contributions exceeding $2,500 per year may be carried over until the full amount of the contribution has been taken as a subtraction. Federal law imposes a $100,000 limit on contributions to a tuition savings plan.

Savings Plan funds can be used for tuition and fees, as well as other qualified higher education expenses (e.g., books, supplies, and room and board). Distributions for qualified higher education expenses are taxable at the beneficiary's effective tax rate. Distributions not used for qualified higher education expenses must be included in the purchaser's Maryland adjusted gross income.

**Background:** MHEIP, an independent State agency directed by a 7-member board, was established in 1997. The board established the Maryland Prepaid College Trust to hold the program's investments. The board also adopted "Maryland Prepaid College Trust" as the marketing name for the program.

MHEIP was created to enhance the accessibility and affordability of a college education by providing for the prepayment of projected in-State tuition and mandatory fees at Maryland public colleges. Parents, grandparents, and other interested persons may purchase a contract based on current tuition and fee amounts. The program offers several tuition plans and payment options. If the beneficiary chooses to attend a private or an out-of-state college, the program will pay the weighted average of tuition and mandatory fees of the Maryland public colleges. Either the purchaser or beneficiary must be a resident of Maryland at the time that the purchaser enters into the contract. MHEIP funds can only be used for college tuition and fees.

Legislation enacted in 1998 established two tax incentives for Maryland residents participating in MHEIP. Purchasers are able to deduct up to $2,500 from their Maryland State income in years they pay into the program. Only one $2,500 subtraction may be taken regardless of the number of prepaid tuition plans contributed to. Contributions exceeding $2,500 may not be carried over. Distributions are tax-deferred while in the program, and are exempt from Maryland State taxes when the contract benefits are used for qualified higher education expenses. For federal tax purposes, distributions are taxed at the beneficiary's rate when the contract benefits are used for qualified higher education expenses.

While MHEIP is a defined benefit plan under which the contract benefits are based on tuition, for the Savings Plan contract benefits are based solely on investment performance. The purchaser decides how much to pay, and the beneficiary receives the contributions plus earnings less an administrative charge.

**State Revenues:** Each $2,500 subtraction would reduce State revenues by $121.25 for tax years 1999 and 2000, $120.00 for tax year 2001, and $118.75 for tax years 2002 and later. The subtraction for each tax year would likely reduce revenues in the following fiscal year when returns are filed. The total amount of the decrease in State revenues cannot be determined at this time.

**State Expenditures:** The Department of Legislative Services has not been provided with information on which to base a comprehensive projection of the fiscal impact of the bill. No other state has a tuition savings plan in place, although states including Virginia, Colorado, and Massachusetts are in the process of implementing tuition savings plans. MHEIP advises that marketing, postage, and printing costs would be incurred as a result of the bill. In addition, MHEIP's operational costs would increase, and MHEIP would probably have to expand its staff above its current level of six employees (assuming that MHEIP staff would administer the program as opposed to the State Treasurer's Office). MHEIP estimates that start-up costs for the Savings Plan could be as high as $1 million in fiscal 2000. Actual costs would depend on operational decisions that have not yet been made; for example, whether there would be one television commercial for both programs or two commercials.

Assuming that the board would hire an independent accounting firm to conduct financial statement audits for the Savings Program, the Office of Legislative Audits would only need to conduct annual fiscal/compliance audits. The annual cost of performing this audit is estimated at $20,000. This cost would be billed to the board pursuant to the bill.

**Local Revenues:** On average, local governments would lose $68.75 for each subtraction of $2,500. The total amount of the decrease in local revenues cannot be determined at this time.

**Information Source(s):** Comptroller of the Treasury (Bureau of Revenue Estimates), Maryland Higher Education Commission, Maryland Higher Education Investment Program, Maryland Independent College and University Association, Department of Legislative Services

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Analysis by: Claire E. Rooney

Direct Inquiries to:
John Rixey, Coordinating Analyst
(410) 946-5510
(301) 970-5510