



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

BILL ANALYSIS



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

Senate Bills 544 through 549 (as introduced 9-12-17)
Sponsor: Senator Patrick J. Colbeck (S.B. 544, 547, & 548)
Senator Phil Pavlov (S.B. 545)
Senator Judy K. Emmons (S.B. 546)
Senator Mike Green (S.B. 549)

Committee: Education

Date Completed: 9-28-17

CONTENT

Senate Bill 544 would enact the "Enhanced Michigan Education Savings Program Act" as Part 2 of the Michigan Education Savings Program Act to do the following:

- Create the Enhanced Michigan Education Savings Program.
- Provide that the Program would consist of one or more saving plans that would allow account distributions for eligible services offered to students by public schools.
- Create the "Enhanced Michigan Education Savings Program Fund".
- Allow the State Treasurer, subject to appropriation, to use Program revenue in the Fund to maintain or enhance the State's education programs.
- Require the Treasurer to enter into a contract with a Program Manager which would act as manager of one or more savings plans offered under the Program and perform specified responsibilities.

Senate Bill 545 would enact provisions of the Enhanced Michigan Education Savings Program Act to do the following:

- Require the Department of Education to determine which services offered by each public school would be eligible services that could be purchased using an account.
- Provide that each public school that complied with Section 1210 of the Revised School Code (proposed by Senate Bill 548) would be eligible to receive payments from the Enhanced Michigan Education Savings Program.
- Allow the Department of Education to designate other organizations as eligible to receive payments from the Program.
- Require the Department to establish and maintain an internet website dedicated to the Program.

Senate Bill 546 would enact provisions of the Enhanced Michigan Education Savings Program Act to prescribe the conditions under which an individual could open, contribute to, and distribute funds from an Enhanced Michigan Education Savings Account (ESA).

Senate Bill 547 would amend the Michigan Education Savings Program Act to designate the existing language as Part 1 of the Act.

Senate Bill 548 would amend the Revised School Code to require a school district, intermediate school district, or public school academy, in order to be eligible to receive funds from the Enhanced Michigan Education Savings Program, to report to the Departments of Treasury and Education certain information about services to pupils and costs.

The bill also would repeal Part 18 (Tuition Pupils) of the Code on August 1, 2018.

Senate Bill 549 would amend the Income Tax Act to allow a taxpayer to deduct from taxable income: 1) contributions, less qualified withdrawals, made pursuant to the proposed Enhanced Michigan Education Savings Program Act, subject to a limit of \$5,000 for a single return and \$10,000 for a joint return per tax year; 2) interest earned on the contributions; and 3) distributions that were qualified withdrawals from an Enhanced Michigan ESA. The bill also would require a taxpayer to add to taxable income the amount of a withdrawal from such an account that was not a qualified withdrawal.

Senate Bills 545, 546, 547, 548, and 549 are tie-barred to Senate Bill 544. Senate Bill 548 also is tie-barred to Senate Bill 549.

Senate Bill 544

Enhanced Michigan Education Savings Program

As noted above, the Enhanced Michigan Education Savings Program Act would be enacted as Part 2 of the Michigan Education Savings Program Act.

The Enhanced Michigan Education Savings Program Fund would be established in the Department of Treasury. The State Treasurer would be required to administer the Fund and would be the trustee for the Fund. Subject to appropriation, the Treasurer could use Program revenue in the Fund to maintain or enhance the State's education programs.

The Department would be required to establish an Enhanced Michigan Education Savings Program, which would consist of one or more savings plans. The purposes, powers, and duties of the Program would be vested in and exercised by the Treasurer or his or her designee.

"Savings plan or plans" would mean a plan or plans that provide different investment strategies and allow account distributions for eligible services.

"Eligible services" would mean any instructional services, supplemental services, and back office services offered to students by a public school that the Department of Education determines pursuant to Part 2 are qualified for payment from an account. Eligible services could include extracurricular services offered by a public school.

Program Manager

The Treasurer could employ or contract with personnel and contract for services necessary for the administration of each savings plan under the Program and the investment of the assets of each savings plan and the Fund under the Program, including managerial, professional, legal, clerical, technical, and administrative personnel or services.

The State Treasurer would be required to solicit proposals from entities to be a Program Manager to provide the services listed above. When selecting a Program Manager, the Treasurer would have to give preference to proposals from single entities that proposed to provide all of the functions described above and that demonstrated the most advantageous

combination, to both potential participants and the State, of the following factors, which the management contract between the Treasurer and the Program Manager would be required to address:

- Financial stability.
- The safety of the investment instruments being offered.
- The ability of the investment instruments to track the increasing costs of higher education.
- The ability of the entity to satisfy the record-keeping and reporting requirements of Part 2.
- The entity's plan for marketing the savings plan and the investment it was willing to make to promote the savings plan.
- The fees, if any, proposed to be charged to people for opening or maintaining an account.
- The ability of the entity to accept electronic withdrawals, including payroll deduction plans.

The Treasurer would be required to enter into a contract with each Program Manager, which would have to address the respective authority and responsibility of the Treasurer and the Program Manager to do all of the following:

- Develop and implement the savings plan or plans offered under the Program.
- Invest the money received in one or more investment instruments.
- Engage the services of consultants on a contractual basis to provide professional and technical assistance and advice.
- Determine the use of financial organizations as account depositories and financial managers.
- Charge, impose, and collect annual administrative fees and service in connection with any agreements, contracts, and transactions relating to individual accounts, exclusive of initial sales charges, which could not exceed 2.0% of the average daily net assets of the account.
- Develop marketing plans and promotional material.
- Establish the methods by which funds would be allocated to pay for administrative costs.
- Provide criteria for terminating and not renewing the management contract.
- Address the ability of the Program Manager to take any action required to keep the savings plan or plans offered under the Program in compliance with requirements of Part 2 and its management contract.
- Keep adequate records of each account and provide the Treasurer with information that he or she required related to those records.
- Compile the information contained in statements required to be prepared under Part 2 and provide that compilation to the Treasurer in a timely manner.
- Hold all accounts for the benefit of the account owner.
- Provide for audits at least annually by a firm of certified public accountants.
- Provide the Treasurer with copies of all regulatory filings and reports related to the savings plan or plans offered under the Program made during the term of the management contract or while the Program Manager was holding any accounts, other than confidential filings or reports except to the extent those filings or reports were related to or a part of the savings plan or plans offered under the Program.
- Ensure that any description of the savings plan or plans offered under the Program, whether in writing or through the use of any media, was consistent with the marketing plan developed by the Program Manager.
- Take any other necessary and proper actions to carry out the purposes of Part 2.

The Program Manager would be required to make available for review by the Treasurer the results of any periodic examination of the Program Manager by any State or Federal banking, insurance, or securities commission, except to the extent that the report or reports were not required to be disclosed under State or Federal Law.

The Treasurer would be responsible for the ongoing supervision of each management contract. A management contract would be for the number of years specified in the contract. The Treasurer could terminate a management contract based on criteria specified in the contract. The Treasurer could enter into contracts that he or she considered necessary and proper for the implementation of the Program.

Reporting Requirements

Each Program Manager would be required to report distributions from an account to a public school for the benefit of the student and distributions from an account for postsecondary education expenses during a tax year to the Internal Revenue Service and the account owner or, to the extent required by Federal law or regulation, to the distributee. ("Student" would mean a pupil enrolled in at least one course in a public school. "Account owner" would mean the parent of the student or the student if he or she is 18 years of age or older.)

Each Program Manager also would be required to provide statements that identified the contributions made during the tax year, the total contributions made to the account for the tax year, the value of the account at the end of the tax year, distributions made during the tax year, and any other information that the Treasurer required, to each account owner on or before the January 31 following the end of each calendar year.

In addition, each Program Manager would be required to disclose the following information in writing to each account owner of an Enhanced Michigan ESA and any other person who requested information about an account:

- The terms and conditions for establishing an account.
- Restrictions on the substitutions of students and transfer of account funds.
- The person entitled to terminate a program agreement.
- The period of time during which a student could receive benefits under the program agreement.
- The terms and conditions under which money could be withdrawn from an account or the Program, including any reasonable charges and fees and penalties that could be imposed for withdrawal.
- The potential tax consequences associated with contributions to and distributions and withdrawals from accounts.
- Investment history and potential growth of account funds and a projection of the impact of the growth of the account funds on the maximum amount allowable in an account.
- All other rights and obligations under program agreements and any other terms, conditions, and provisions of a contract or an agreement entered into under Part 2.

Scope of Part 2

Part 2 and any agreement under it could not be construed or interpreted to do any of the following:

- Guarantee that a student would be admitted to a public school of his or her choice or, upon admission to a public school, would be permitted to continue to attend or would receive a degree from the public school.
- Guarantee that amounts contributed to an account would be sufficient to cover the eligible services of a student.

Part 2 would not create and could not be construed to create any obligation upon this State or any agency or instrumentality of this State to guarantee for the benefit of an account owner or student any of the following:

- The rate of interest or other return on an account.
- The payment of interest or other return on an account.

The contracts, applications, deposit slips, and other similar documents used in connection with a contribution to an account would clearly indicate that the account is not insured by this State and that the money deposited into and investment return earned on an account are not guaranteed by this State.

Annual Report

Each Program Manager would have to file with the Treasurer and the Board an annual report that included all of the following:

- The names and identification numbers of account owners and students. The information reported pursuant to this subdivision is not subject to the Freedom of Information Act.
- The total amount contributed to all accounts during the year.
- All distributions from all accounts.
- Any information that the Program Manager or Treasurer may require regarding the taxation of amounts contributed to or withdrawn from accounts.

Tax Exemption

Contributions to and interest earned on an account and withdrawals made from an account would be exempt from taxation as provided in Section 30 of the Income Tax Act (which Senate Bill 549 would amend).

Senate Bill 545

From the information received from each public school pursuant to Section 1210 of the Revised School Code (proposed by Senate Bill 548), the Department of Education would have to determine which services offered by each public school were eligible services that could be purchased using an account. The Department would have to divide the eligible services into five separate categories as follows:

- Core instruction.
- Noncore instruction.
- Extracurricular activities.
- Support activities.
- Course materials.

Each public school that complied with Section 1210 would be eligible to receive payments from the Program. The Department of Treasury could designate other organizations that provided core and noncore instruction services, extracurricular and support activities, and course materials as eligible to receive payments from the Program.

Within one year after the bill's effective date, the Department of Treasury, in consultation with the Department of Education, would have to establish and maintain an internet website dedicated to the Program. The website would have to serve as the portal for information about the Enhanced Michigan ESAs and the eligible services offered by each public school in the State. The website would have to include at least all of the following:

- A breakdown of the minimum requirements for annual course loads and course descriptions.
- A mechanism for the enrollment of students into services and to allow for the payment of those eligible services from each student's account by the account owner.

- A default selection for eligible services based on the grade level of the student for parents who elected not to choose the courses and subject areas for their students.

Senate Bill 546

Beginning with the school year starting one year after the effective date of the Enhanced Michigan Education Savings Program Act, parents could open an account for each dependent who was a student to allow for the enrollment in and payment for eligible services offered by a public school for that student and to pay for postsecondary education expenses. A parent could open only one account for each dependent.

To open an account, the parent would be required to enter into a program agreement with the Enhanced Michigan Education Savings Program. The program agreement would have to be in the form prescribed by a Program Manager and approved by the State Treasurer and contain all of the following:

- The name, address, and Social Security number of the parent.
- The name, address, and Social Security number of the student.
- Any other information that the Treasurer or Program Manager considered necessary for the enrollment of the student and related to the eligible services.

Any individual or entity could make contributions to an account. Any contributions to an account would have to be made in cash, by check, by credit card, or by any similar method as approved by the State Treasurer, but could not be property.

An account owner would be responsible for the payment of eligible services and any postsecondary education expenses. Distributions from an account to pay for eligible services would have to be paid directly to the public school in which the eligible services were to be provided. Distributions from an account to pay for education postsecondary education expenses could be paid to the account owner or to the institution providing the postsecondary education. Payments could be made electronically.

Each savings plan under the Program would have to provide separate accounting for each student.

Upon graduation from a public school, an account owner could transfer funds back to the Enhanced Michigan Education Savings Program Fund or use the remaining funds to pay for postsecondary education expenses.

Upon the death of the student, the account would have to be closed and that portion of the money in the account that was deposited as described above would have to be transferred back into the Enhanced Michigan Education Savings Program Fund.

An account owner could not direct the investment of any contributions to an account or the earnings on an account. An account owner could, however, select among different investment strategies designed by a Program Manager to the extent allowed under Part 2. The Program could allow board members or employees of the Program, or the board members or employees of a contractor hired by the Program to perform administrative services, to make contributions to an account. An interest in an account could not be used by an account owner as security for a loan. Any pledge of an interest in an account would have no force or effect.

Senate Bill 547

The bill would designate the Michigan Education Savings Program Act as Part 1 of the Act.

Senate Bill 548

The bill provides that for a school district, intermediate school district, or public school academy to be eligible to receive funds from Enhanced Michigan Education Savings Program accounts, by March 1, 2018, and then at least six months before the start of each school year, the board of a school district or intermediate school district (ISD) or board of directors of a public school academy (PSA) would be required to submit to the Department of Education and the Department of Treasury, in the form and manner prescribed by the Departments, all of the following:

- A complete listing of all services to be provided to pupils by the school district, ISD, or PSA, broken down by subject-specific core instructional services, noncore instructional services, extracurricular activities, support activities, and course materials, with each of the eligible services mapped to the funding sources for the service.
- A breakdown of the direct costs and fully burdened costs to the school district, ISD, or PSA for providing each of the services listed above.
- Any other information requested by the Department of Treasury related to services provided to pupils by the school district, ISD, or PSA.

The Department of Education and a school district, intermediate school district, or public school academy would be required to ensure that parents had access to information on the direct costs and fully burdened costs of each eligible service.

At least six months before the start of each school year, a school district, ISD, or PSA would be required to provide to parents clear information on which eligible services were available from the school district, intermediate school district, or public school academy.

"Eligible service" would mean a service that may be purchased using an Enhanced Michigan Education Savings Program account, as prescribed by the Department of Education under the Enhanced Michigan Education Savings Program Act.

Senate Bill 549

Part 1 of the Income Tax Act defines "taxable income", for a person other than a corporation, estate, or trust, as adjusted gross income as defined in the Internal Revenue Code, subject to the addition or deduction of certain amounts.

For the 2018 tax year and each subsequent tax year, the bill would allow a taxpayer to deduct, to the extent not deducted in determining adjusted gross income, contributions made by the taxpayer in the tax year less qualified withdrawals made in the tax year from Enhanced Michigan ESAs, calculated on a per-account basis, pursuant to the Enhanced Michigan Education Savings Program Act. The adjustment could not exceed a total deduction of \$5,000 for a single return or \$10,000 for a joint return per tax year. The amount calculated for each Enhanced Michigan ESA could not be less than zero.

In addition, beginning with the 2018 tax year, the bill would allow a taxpayer to deduct both of the following:

- Interest earned in the tax year on the contributions to the taxpayer's Enhanced Michigan ESAs if the contributions were deductible as provided above.
- Distributions that were qualified withdrawals from an Enhanced Michigan ESA.

Also, for the 2018 tax year and each subsequent tax year, the bill would require a taxpayer to add to taxable income, to the extent not included in adjusted gross income, the amount of money the taxpayer withdrew in the tax year from Enhanced Michigan ESAs, not to exceed

the total amount deducted under the bill in the tax year and all previous tax years, if the withdrawal were not a qualified withdrawal. This provision would not apply to withdrawals that were less than the sum of all contributions made to an Enhanced Michigan ESA in all previous tax years for which no deduction was claimed under the bill, less any contributions for which no deduction was claimed that were withdrawn in all previous tax years.

(As defined in Senate Bill 544, "qualified withdrawal" would mean a distribution that is not subject to a penalty under Part 2 of the Michigan Education Savings Program Act or taxation under the Income Tax Act, and that meets any of the following:

- A withdrawal from an account to pay for eligible services provided by a public school to the student to pay for postsecondary education expenses incurred after the account is established.
- A transfer of funds due to the termination of the management contract.
- A transfer of funds upon the student's graduation or death.)

Proposed MCL 390.1487 et al. (S.B. 544)

Legislative Analyst: Nathan Leaman

Proposed MCL 390.1491 & 390.1492 (S.B. 545)

Proposed MCL 390.1493 - 390.1495 (S.B. 546)

MCL 390.1471 et al. (S.B. 547)

Proposed MCL 380.1210 (S.B. 548)

MCL 206.30 & 206.30f (S.B. 549)

FISCAL IMPACT

Senate Bills 544 to 548

The bills would have a significant fiscal impact on the Department of Treasury, Department of Education, Center for Education Performance and Information (CEPI), and local school districts. The Department of Treasury would incur both one-time and ongoing costs. The administration, oversight, auditing, security, and data storage of the Enhanced Michigan Education Savings Program (E-MESP) would involve the student financial services, investments, and accounting divisions of the Department. At this time, the exact cost of creating an information technology system in one year is difficult to estimate as it would need an initial capacity of roughly 1.5 million accounts (approximately the number of K-12 students enrolled at present), and it would need to have the capacity to expand each year by the number of newly enrolled students (around 120,000 annually).

In addition, the system would need the ability to make payments to multiple providers and receive deposits from multiple providers, as well as the ability to add, remove, and adjust the cost for eligible services. Though an exact cost cannot be estimated at this time, based on the cost of the existing MESP, combined with the additional complexity, numbers of accounts, and time required to implement the Program, a rough estimate of the cost to create the system could range between \$60.0 million and \$100.0 million. This cost could be paid for in a variety of ways that would affect the Department either more directly or indirectly. If a vendor could provide this service, then the implementation costs could be spread out as an administrative fee and/or a transaction fee on account holders. Additionally, the system would have ongoing operational costs. Currently, the MESP pays for the \$76.0 million cost of the Program through a three-year contract that charges a percentage of the investment earnings to pay for the cost of implementation and management of the Program. Those costs are related to the value of assets under management; as the Program grows, the costs increase. Furthermore, those costs exclude the Department of Treasury's expenses to oversee the MESP. If a vendor were not found for the E-MESP and the Department had to construct the system, then the Department would directly bear the costs.

After the initial one-time cost, the ongoing administration by the Department of Treasury (in addition to establishing and maintaining an internet website dedicated to the E-MESP) would result in additional costs. At this time, it is unknown whether the amount Treasury would be allowed to charge as annual administrative fees (up to 2.0% of the average daily net assets of an account) would be sufficient to pay for managing account contracts and the ongoing administration and marketing of the Program. Arizona's scholarship account program uses 4.0% of the scholarship value toward administration of the program and Nevada uses 3.0% of scholarship value toward administration of the program. This would place Michigan's 2.0% administrative fee cap lower than the fee in other states that have individual education scholarship account programs.

The Department of Education likely would incur additional costs associated with determining which services offered by public schools and other organizations would be eligible services that could be purchased using an E-MESP account. At this time, the exact cost to the Department is unknown. Since the Department of Education would not have explicit access to the administrative fee, it is unclear whether any additional costs could be covered by the fee or would require additional appropriations.

The CEPI would incur additional costs in order to ensure that student records could keep track of education services gained outside of the student's primary district, such as work study programs.

Local school districts would likely incur annual costs associated with estimating the "direct costs and fully burdened costs" for eligible services, and processing the enrollment of students in those various services. Since schools do not typically calculate costs for each individual education service, outside consultation and training could be necessary for initial implementation. The cost of these duties is difficult to estimate given the difference in school types and the amount of eligible services that districts would seek to provide. Local school districts could see increased revenue to the extent parents would choose to purchase additional district services (beyond those provided to the students funded from "traditional" State school aid dollars), using funds deposited by the family or other private sources into an E-MESP account.

Senate Bill 549

The bill would reduce General Fund and School Aid Fund revenue by an unknown, and potentially significant amount, depending on the number and characteristics of taxpayers affected by the bills. The proposed legislation would affect a wider array of taxpayers, and cover a broader array of expenses, than current education saving account provisions, which are estimated to reduce State revenue in fiscal year 2016-17 by approximately \$13.7 million. As a result, Senate Bill 549 would likely reduce State revenue by more, and possibly significantly more, than \$13.7 million.

Several provisions in the bills exhibit unclear language that could affect the fiscal impact. For example, Senate Bill 544 would define "qualified withdrawal" but the definition would not include withdrawals to pay education expenses that were not for postsecondary costs, meaning that withdrawals to pay for services offered by school districts, intermediate school districts, and public school academies under the other bills would not represent qualified withdrawals. However, Senate Bill 544 also indicates that withdrawals, not just qualified withdrawals, would be exempt from taxation as provided in Section 30 of the Income Tax Act--although the changes to Section 30 proposed by Senate Bill 549 generally would retain the limitation under which only qualified withdrawals could be deducted. (The bill contains an exception that would allow a taxpayer to forgo adding a withdrawal to income if the withdrawals were less than amounts contributed.) However, contributions would be deductible

regardless of whether the withdrawals were qualified. Similarly, Senate Bill 548 (S-2) refers to "fully burdened costs", a term not defined by the bills, and it is unclear whether such costs would represent expenses that would be considered qualified withdrawals.

Participation could be affected by provisions that would require, upon the death of student, money in the account to return to the Michigan Education Savings Program Fund. When a beneficiary dies under existing education savings program contracts, the taxpayer may withdraw funds from the account and all taxpayer withdrawals associated with the student are qualified withdrawals. Similarly, some taxpayers could reduce their contributions to existing ESAs and direct money to the accounts created by the bills, thereby reducing the fiscal impact--although if the taxpayers contributed more to the new accounts, because a wider array of expenses would be covered, such a shift could still increase the revenue loss.

The bills would appear to allow taxpayers to exempt income spent on a variety of current expenses. For example, approximately half of Michigan's public high schools require participants in a variety of athletic or academic programs to pay a fee to participate in the activity, and almost 80.0% do or are considering assessing the fee annually. Fees range from \$20 to \$425 per student, with a median fee of \$150. It is unknown what other costs, for example costs associated with school lunches, instrument rental, or damage to textbooks or school-issued computers, would represent eligible expenses under the bills. However, the bills would appear to allow parents to direct money used to pay many of these fees or expenses through accounts created under the bills, thereby exempting the income used to pay such costs from taxation. As a result, schools would have an incentive to levy fees for more activities or purposes and/or increase existing fees.

Approximately 80.0% of public school students participate in some form of extracurricular activity, and although the percentage of those activities that are offered via the school is unknown, other data suggest the figure could be significant. For example, approximately 300,000 students each year participate in a sport offered by a public high school (although this figure counts students in multiple sports as more than one student). There are approximately 1.5 million Michigan public school students, and these students may participate in other activities beyond athletics that are associated with a fee, such as theatre, debate/forensics, quiz bowl, social clubs, community service groups, Science Olympiad, and robotics. (Approximately one-third of Michigan public schools levy participation fees for nonathletic activities.) If accounts were created for 25.0% of public school students, and an average \$1,000 per student were deposited each year, the bills would reduce revenue by approximately \$15.9 million per year. Greater participation and/or greater average contribution amounts would increase the loss of revenue; similarly, less participation and/or lower average contributions would reduce the loss of revenue. For example, if accounts were created for 35.0% of students, and the average deduction were \$2,500, the bills would reduce revenue by \$55.8 million. (The bills would allow a maximum of \$5,000 for a single filer or \$10,000 for a joint return to be deducted, and contributions could be used to pay more expenses than participation fees.)

Fiscal Analyst: Cory Savino
Kathryn Summers
David Zin

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