

SB

187

GARY WILKEN

SENATOR

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and Social Services (HESS)
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SPONSOR STATEMENT

SB 187 – University Tuition Payment Program

In August 1996, Congress passed legislation that exempts qualified state prepaid tuition programs from income taxes similar to exemptions provided other non-profit activities. Senate Bill 187 makes the necessary statutory changes to conform the Advance College Tuition (ACT) payment plan with the new federal law.

The ACT plan, established in 1990 under AS 14.40.803, offers an incentive for Alaskan residents to save for college. Under this plan one-half of a participating individual's annual permanent fund dividend can be used to prepay college tuition credits at the current cost per credit. The University of Alaska guarantees that ACT credits can be used for tuition *regardless of the amount paid for the ACT credit or the cost of tuition at the time they are used*. Currently there are over 6,300 prepaid tuition contracts in place totaling approximately \$17.6 million.

On February 14, 1997, the University of Alaska Board of Regents adopted a revised ACT plan which conforms to the new federal requirements. The changes proposed in SB 187 will strengthen the Advance College Tuition exempt status with IRS. Failure to comply with the new tax law in a timely manner could result in retroactive taxation of the program back to 1991 and destroy the financial viability of this very worthwhile program. For this reason, I recommend passage of Senate Bill 187.



University of Alaska
Statewide System of Higher Education

THE ALASKA ADVANCE COLLEGE TUITION PAYMENT FUND

The Alaska Advance College Tuition (ACT) Payment Fund, as established in 1990 under AS 14.40.803, was created by the legislature to provide an incentive for Alaskans of all ages to continue and complete their secondary and post-secondary education. The ACT plan provides for future redemption or refund of ACT credits for payment of tuition and other qualified higher education expenses at the University of Alaska or any eligible college, university or vocational/technical institution.

The ACT fund consists of permanent fund dividend (PFD) and cash contributions under the terms of an advance college tuition payment contract. Under the PFD program, half of a participating individual's annual PFD dividend can be deposited directly into the ACT fund. Currently, there are over 6,300 pre-paid tuition contracts in place totaling approximately \$17.6 million. The Commissioner of Revenue is the custodian of the fund and the University of Alaska Board of Regents administers the program.

P.L. 104-188, signed into law on August 20, 1996, included a provision of the Internal Revenue Code (Section 529) that defined the federal tax treatment of qualified state tuition programs, thereby clarifying the tax-exempt status of the ACT fund and the tax-deferred status of a participant's earnings on any increase in value of ACT credits prior to actual use. Congress has given states with pre-paid tuition programs until August 1997 to bring their plans into conformance with the new law. The University Board of Regents has revised the ACT plan to conform with federal legislation; however, state statute changes are also necessary to better assure full compliance. Although the Internal Revenue Service will make any final determination, failure to pass conforming state legislation could result in retroactive taxation of the ACT program and its participants back to 1991 and virtually eliminate the financial viability of the program.

Senate Bill 187
Sectional Analysis
Advance College Tuition (ACT) Program

Purpose of the bill:

The bill is intended primarily to conform the state statutes related to the Advance College Tuition payment plan with federal tax legislation passed by Congress with the help of Senators Murkowski and Stevens as part of the Small Business Job Protection Act in August 1996. On February 14, 1997, the Board of Regents adopted a revised ACT Plan which was intended to conform the Plan and operation of the program to the new requirements. Congress has given prepaid tuition programs until August 1997 to bring their plans into conformance with the new law. The Internal Revenue Service (IRS) will make all determinations regarding compliance and have not yet issued any regulations or guidelines on the issues. Although the university believes that the revised ACT Plan adopted by the Board of Regents in February is adequate to comply with the new law, the proposed changes to the statute included herein will be of substantial assistance in making that argument with the IRS. Failure to comply with the new tax law in a timely manner could result in retroactive taxation of the program back to 1991 and destroy the financial viability of the program.

Section 1

AS 09.25.120(a) is amended to limit access of public records requests for personal identifying information of participants in the ACT program. The ACT records include social security numbers of purchasers and beneficiaries and personal financial information regarding amounts deposited with the Fund and the values of any participants interest in the program.

Section 2

AS 14.40.803(b)(2) is amended to eliminate unnecessary wording regarding contributions to the fund, if any.

Advance College Tuition Program

Section 3

AS 14.40.803(c) is amended to authorize payments to other eligible educational institutions, if payments to other institutions are required. Internal Revenue Service (IRS) regulations are expected to provide certain safe harbor provisions to qualified state tuition programs if payments are made directly to an eligible educational institution. An "eligible educational institution" is a defined term under the Internal Revenue Code (Code).

Section 4

AS 14.40.805(11) is amended to add the word "awards" in order to make the terminology the same as that used in AS 14.40.803(c).

Section 5

AS 14.40.809(a) is amended to clarify that ACT credits can be used for payment of "qualified higher education expenses," which are defined in the Code (basically tuition, fees, books, supplies, and potentially room and board at some future time). This change is beneficial to participants in that it allows tax deferred savings for certain expenses in addition to pure tuition. It also limits the sale of tax deferred ACT credits to purposes of funding "qualified higher education expenses" as required by federal law. In order for a prepaid tuition plan to be exempt from federal income tax, redemptions must be limited to use for "qualified higher education expenses" at an "eligible educational institution."

AS 14.40.809(a) is amended to clarify that students can utilize ACT credits for tuition and qualified expenses at other "eligible institutions." This change is beneficial to participants in that credits can be redeemed for use at institutions other than the University of Alaska. It also limits the sale of tax deferred ACT credits to use at an eligible institution as required by federal law. In order for a prepaid tuition plan to be exempt from federal income tax, redemptions must be limited to use for "qualified higher education expenses" at an "eligible educational institution."

AS 14.40.809(b)(2) is amended to indicate that the formal Plan adopted by the Board of Regents is part of the contract with the purchaser. This is intended to emphasize the fact that the terms and conditions of the ACT Plan will be deemed part of the ACT contract.

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AS 14.40.809(b)(4) is amended to allow the Board of Regents to enter into reciprocal agreements with other eligible educational institutions or qualified state tuition programs as considered beneficial by the Board of Regents. The Code provides for rollover provisions which are yet to be defined in IRS regulations. The university believes that it may be advantageous for participants or for qualified state programs to allow reciprocal transfers of participants between contracts, institutions, or between state programs. Although reciprocal agreements with Sheldon Jackson University and Alaska Pacific University have been authorized by statute, uncertain tax treatment of the program itself and the benefits to participants has made consideration of any such agreement unfeasible.

AS 14.40.809(b)(5) is deleted as unnecessary. This provision was added to the statutes in an effort to seek exemption of the ACT program income tax as an integral part of a tax exempt instrumentality of the state. Passage of Section 529 of the Internal Revenue Code last year eliminated the need for this provision. The commitments under the ACT Plan are, and will continue to be, a contractual obligation of the university in accordance with the terms and conditions of the ACT Plan; however, the university does not intend to make ACT participants a special or preferred class of creditors.

Section 6

AS 14.40.811(a)(1) is amended to delete the provisions related to installment contracts. This provision was included in the law prior to development of the ACT program. It was intended to apply to a situation where a purchaser would agree to payment for four years of education to be paid in installments in advance of coming to school. This provision is currently non-functional because the ACT program developed into a unitized program, where a purchaser receives the number of units of education that were paid for rather than making a contractual commitment to make payments in the future. Under the ACT program, there is no commitment to purchase or pay for any specified number of additional units or credits.

AS 14.40.811(a)(2),(3), and (5) are amended to clarify some of the essential information which is required for a prepaid tuition contract including name and date of birth of the purchaser and the beneficiary (prospective student), the number of credits purchased, and the commitment by the Board of Regents to provide education to the beneficiary in accordance with the terms and conditions of the Plan.

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AS 14.40.811(a)(7) is amended to clarify the Board of Regents will make whatever terms and condition are required by the Internal Revenue Code part of the contract with participants of the program.

Section 7

AS 14.40.817(1) is amended to clarify that "contract" as used in AS 14.40.803 - 14.40.817 means an ACT Contract.

AS 14.40.817(2) is amended to make the definition of a beneficiary under state statute the same as the definition under the Internal Revenue Code. The concept of residency for eligibility is unchanged and is retained in the formal Plan adopted by the Board of Regents.

AS 14.40. 817(4) and (8) are added to adopt the same meaning for an "eligible educational institution" and "qualified higher education expenses" as provided by the Internal Revenue Code. These definitions are critical to federal tax treatment under the Code.

AS 14.40. 817(7) is amended to clarify who is the contracting party or purchaser and to accommodate situations where payments under a contract are made by persons, such as grandparents, who are not the formally named as a purchaser or participant under a contract.

FISCAL NOTE

**STATE OF ALASKA
1997 LEGISLATIVE SESSION**

BILL NO. SB 187

Revision Date:
Title: An Act relating to disclosure of public records...of the
Alaska advance college tuition payment fund.
Sponsor: Senator Wilken
Requestor:

Department Affected: **University of Alaska**
BRU: **All**
Component:

COMPONENT SERIAL NO.

EXPENDITURES/REVENUES: (Thousands of Dollars)

OPERATING	FY98	FY99	FY00	FY01	FY02	FY03
PERSONAL SERVICES						
TRAVEL						
CONTRACTUAL						
SUPPLIES						
EQUIPMENT						
LAND & STRUCTURES						
GRANTS, CLAIMS						
MISCELLANEOUS						
TOTAL OPERATING	0.0	0.0	0.0	0.0	0.0	0.0

CAPITAL						
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REVENUE FD SOURCE						
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FUNDING: (Thousands of Dollars)						
1002 FEDERAL FUNDS						
1003 GF MATCH						
1004 GENERAL FUND						
1006 GF/MHTIA						
OTHER						
TOTAL FUNDING	0.0	0.0	0.0	0.0	0.0	0.0

POSITIONS:						
FULL-TIME						
PART-TIME						
TEMPORARY						

Estimate of current year impact: None

ANALYSIS: (Attach a separate page if necessary.)

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Date: 4/25/97

Approved by: Marylou Burton, Director
Agency: Statewide Budget Office - U.S. Alaska

Date: 4/25/97

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