

Approved On: _____

Minutes of the House Committee on Taxation. The meeting was called to order by E. C. Rolfs, Chairman, at 9:00 a.m. on March 1, 1988 in room 519 South at the Capitol of the State of Kansas.

The following members were absent (excused):

Representatives Crowell and Leach

Committee staff present:

Tom Severn, Legislative Research
Chris Courtright, Legislative Research
Don Hayward, Reviser of Statutes
Millie Foose, Committee Secretary

Representative Rick Bowden spoke as a proponent for HB-2877 - AN ACT relating to income taxation; concerning modifications to adjusted gross income for certain college education savings account contributions. (Attachment 1) This bill would permit a family or individual to reduce from their federal adjusted gross income the amount of interest earned on contributions to such an educational savings plan up to \$1200 of principal contributed to that plan. He said that financing a college education has become a serious problem and many other states are looking at ways to address the problem. He provided information comparing the plans of Illinois, Michigan, and Tennessee. He answered questions from committee members and discussed ways this plan would benefit the colleges as well as the students.

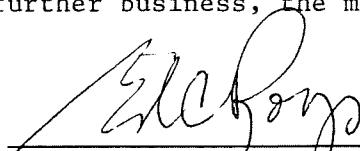
Mark Tallman, Legislative Director for Associated Students of Kansas, expressed his support for HB-2877 and also that of ASK. He outlined four plans -- Prepaid Tuition, Publicly Administered Education Trust Accounts, Private Sector Individual Education Accounts, and Zero Coupon Education Savings Bonds. He gave reasons to support a college savings program and the advantages. (Attachment 2) He also submitted a report on Policy Options. (Attachment 3) This concluded the public hearing on HB-2877.

Representative Jim Lowther and Mr. Harry Stephenson, Emporia State University, discussed HB-2735 - AN ACT relating to income taxation; concerning credits for contributions made to postsecondary educational institutions. Mr. Stephenson explained Emporia State's \$12 million endowment program and the benefits to the students and to the college. Representative Lowther also said this would benefit all the colleges -- the private ones as well as the state and attract many students who would not be able to attend without a plan similar to this.

Chairman Rolfs outlined his plans and said the committee would be considering HB-2959 and HB-3015 within the next week. He also discussed HCR-5016 - A PROPOSITION to amend article 7 of the constitution of the state of Kansas, and said this would be on an early agenda.

The minutes of February 24 were approved.

There being no further business, the meeting was adjourned.



Ed C. Rolfs, Chairman

TO: Chairman Rolfs and Members of the House Taxation Committee:
FROM: Representative Rick Bowden

Thank you for the opportunity to appear today on HB 2877. Early last summer, I approached Representative Elaine Hassler about the possibility of working together to seek solutions to a persistent and growing problem affecting any family in Kansas that has a child desiring to attend college. That problem is how to save enough money to pay a child's college education costs. I believe later conferees will present figures on the magnitude of the dollar cost today's college students are facing when looking at college expenses.

Representative Hassler and I quickly agreed that the group we were most concerned about helping was the "middle class". We felt this was that group of Kansas Parents who were unable to simply sit down and write out a check to cover a semester's cost without severely affecting their personal or family resources; or they had just enough income and resources to disqualify them for many or any aid programs. These families are the ones, in many cases, that will have to go into substantial financial debt in order to provide for their child's college education.

Many other states are looking at ways to address the same problem or concern. From our research, we found that several general programs are being considered in other states. One is the guaranteed tuition plan, normally modeled after the Michigan Educational Trust (MET) Plan. Another plan gaining growing acceptance, involves the purchasing of educational bonds, as per the Illinois model. The third option is the educational savings concept. It is upon this third concept that HB 2877 is modeled. It is very similar to an IRA but for our purposes it is to be used to cover educational costs rather than retirement security as an IRA does.

The problem both Representative Hassler and I had difficulty addressing was "what do we use to encourage parents/family to save now for future educational costs"; i.e. what carrot can we use that is attractive enough that they are willing to bite. One, but certainly not the only carrot, is to provide these families some financial reason to save their dollars. Again, modeling after the IRA programs we opted for the proposal put forward in this Bill.

HB 2877 permits a family or individual to reduce from their federal adjusted gross income the amount of interest earned on contributions to such an educational saving plan and up to \$1200 of principal contributed to that plan. If an individual withdraws money from this account and uses it for any reason other than payment of educational expenses, they are subject to a tax equal to 10% of the total amount in such an account. The Bill also contains a provision to permit the withdrawal, without penalty, in case of death or incapacitation of a student such that it would preclude his/her attendance at a post secondary institution.

I want to be open and frank with the Committee Members. There may well be more questions than answers with respect to the savings plan proposal in this particular Bill. However, I would hope you share with me the valid concern about how can we in Kansas deal with a real problem facing Kansas Families - meeting the soaring costs of secondary education. It would indeed be a tragedy for any person wanting to further his/her education to be denied the chance solely because they could not afford it. This is a proposal that encourages individuals to save for college now, anticipating the need in the future.



**Education Commission
of the
States**

Headquarters Office
Suite 300
1860 Lincoln Street
Denver, Colorado 80295-0301
303-830-3600

Washington Office
248 Hall of the States
444 N. Capitol Street, NW
Washington, D.C. 20001-1572
202-624-5838

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1987-88**

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ECS MEMORANDUM

DATE: 9 December 1987

TO: All Concerned

FROM: Jennifer Afton

RE: Survey of State Proposals for Tuition Prepayment Plans and Incentive Plans for Saving for College

Enclosed is a state-by-state survey briefly outlining actions that each state has taken in regard to the above.

We realize that in some states the status of these actions may change rapidly. A survey being only a snapshot in time, some of this information may already need updating. If this is true for your state (or if you wish to add to or change anything) please contact either Dr. Aims McGuinness at (303) 830-3614 or myself at 830-3669.

10/26/87

**EDUCATION COMMISSION OF THE STATES
SURVEY OF STATE PROPOSALS FOR TUITION PREPAYMENT PLANS
AND INCENTIVE PLANS FOR SAVING FOR COLLEGE**

State	Level Of Interest	Type of Proposal				Other Proposals	Enacted Vetoed Underway	Study/Interim Committee	Comments
		Tuition Guarantee	Savings Program	Interim Studies	IRS Contingent				
AL	Low								Informal discussion.
AK	Low								
AZ	Low								Informal discussion.
AR	Low			X				Interim study planned to design legislation for 1989 session.	
CA	High	X	X				Tuition guarantee & savings bond plans both vetoed 10/87. Governor's reasons: 1) plan not tested, 2) is government responsible for providing a savings plan, especially with numerous private sector plans? 3) possible future unknown costs to state.		
CO	Low								Bill to study was dropped. No action at this time

State	Level Of Interest	Type of Proposal				Other Proposals	Enacted Vetoed Underway	Study/Interim Committee	Comments
		Tuition Guarantee	Savings Program	Interim Studies	IRS Contingent				
CT	Moderate			X				Tuition guarantee bill dropped in 1987 session. Interim group to study various alternatives.	
DE	Low			X				General assembly resolution asked sec. of finance to investigate issue & report back 1/88.	
FL	High	X			Yes ¹	Education reinvestment act to permit AFDC recipients to set aside 10% of welfare payments in trust for education of children	Enacted 7/1/87, "Florida Postsecondary Cost Stabilization Fund" or "Florida Pre-paid Postsecondary Education Expense Program". Includes 3 plans: 1) community college plan 2) university plan, & 3) dormitory residence plan. Fully implemented in 1988-89.		
GA	High	X	X	X			AFDC trust proposal passed senate. Carried over to 1988 session.	Alternatives for 1988 session being studied by regents & by house & senate committees	
HI	Low								
ID	Low								Proposals possible mid-January 1988 when new session begins.

State	Level Of Interest	Type of Proposal				Other Proposals	Enacted Vetoed Underway	Study/Interim Committee	Comments
		Tuition Guarantee	Savings Program	Interim Studies	IRS Contingent				
IL	High		X					<p><u>Amendatory veto of savings bond plan by Governor. Governor expected to sign after certain language changes. Two savings plan bills & one pre-paid tuition plan were vetoed.</u></p>	<p>State general obligation bonds to be issued as zero coupon college savings bonds. Interest earnings exempt from fed/state income taxes. State to add .25% interest if used for Illinois public or private college.</p>
IN	High	X			Yes ¹			<p><u>Enacted tuition prepayment plan. Provides: 1) 4-year, 124 credit hour plan w/principle minus admin fee refund, 2) same but w/interest refund, 3) 2-year plan same as 1). Bill effective 7/1/87; trust board must report to gen. assembly on/before 1/1/88 & trust may contact w/purchasers after 6/30/88.</u></p>	<p>Contract between purchaser & trust only. State & university make no guarantees.</p>
IA	Moderate	X						<p>Resolution to study issue was drafted but not acted upon. Tuition prepayment proposa debated in 1987 session.</p>	
KS	Low		X					<p>Associated Students of Kansas has proposed a tax-deferred savings plan for 1988 session. Unsuccessful candidate for governor in 1986 wanted to propose a tuition prepayment plan. No action in 1987.</p>	

State	Level Of Interest	Type of Proposal					Other Proposals	Enacted Vetoed Underway	Study/Interim Committee	Comments
		Tuition Guarantee	Savings Program	Interim Studies	IRS	Contingent				
KY	Moderate	X	X	X					Proposal was developed by staff of KY Higher Ed Assistance Authority, Council on Higher Ed, & Council of Independent KY Colleges & Universities, was adopted by their boards & presented to the interim joint committee on education for study & consideration.	
LA	Moderate	X		X					Interim study requested 6/87. Two senate & 2 house bills previously introduced but did not pass.	
ME	High	X					Yes ¹		Enacted 6/87, pre-payment plan, Student Education Deposit Plan (SEED). Room & board not included Board of directors for the plan not yet appointed.	State allows high school students to take college courses free of charge thus saving on tuition, fees, room & board & easing the transition into college.

State	Level Of Interest	Type of Proposal				Other Proposals	Enacted Vetoed Underway	Study/Interim Committee	Comments
		Tuition Guarantee	Savings Program	Interim Studies	IRS Contingent				
MD	Moderate			X				Legislative subcommittee issued report rejecting all plans except possibly a savings plan. Governor's task force will make the same recommendation late October/early November 1988. Considering private savings plans with state coupons attached.	
MA	High	X	X	X				At governor's request board of regent's committee is studying issue. Draft proposal for both savings bonds & tuition prepayment certificates. Independents could participate fully. Report should be in by mid-Fall 1987. Aiming at comprehensive plan that will include independent institutions; also possible regional reciprocal provisions.	
MI	High	X				Yes	Enacted 12/86, tuition prepayment plan		

State	Level Of Interest	Type of Proposal					Other Proposals	Enacted Vetoed Underway	Study/Interim Committee	Comments
		Tuition Guarantee	Savings Program	Interim Studies	IRS Contingent					
MN	High	X		X					Proposed bill laid over interim for study. Two studies underway. MN higher ed coordinating board studying overall issue & legislature studying overall issue & specific legislation. Possibility legislature won't accept anything in which the state has liability.	Bill was introduced but died in committee.
MS	Low	X								
MO	High	X	X	X					Savings & guaranteed tuition bills were actively debated in 1987 legislature. One bill would propose IRA type savings accounts for tuition only. Study by joint interim committee on access to higher ed underway.	
MT	Low									Studying pros & cons. Collecting information. Governor has expressed some interest. No action in 1987.
NE	Low									Waiting to see what other states are doing & how IRS rules.

State	Level Of Interest	Type of Proposal				Other Proposals	Enacted Vetoed Underway	Study/Interim Committee	Comments
		Tuition Guarantee	Savings Program	Interim Studies	IRS Contingent				
NV	Low							Board of Regents decided, after study, to postpone action until after IRS rules.	
NH	Low	X		X			Bill has been referred to interim committee which is currently studying it.		
NJ	High	X		X		Proposed senate bill passed; still waiting on assembly bill. Senate bill has provisions for participation by independent institutions; purchase of tuition by certificate; & that at least 90% of tuition will be paid to participating institutions.			
NM	Low							Bill proposed but it died. No further legislation proposed. May consider educating the public about the wisdom of saving. Concerns that prepayment plans require too much state involvement & are fiduciarily risky.	
NY	Moderate	X	X	X		Regents College Savings Fund proposal would establish individual education accounts similar to IRA's; includes matching funds for low income participants.	Senate research service completing study.	Several bills proposed and considered including prepayment plan.	

State	Level Of Interest	Type of Proposal				Other Proposals	Enacted Vetoed Underway	Study/Interim Committee	Comments
		Tuition Guarantee	Savings Program	Interim Studies	IRS Contingent				
NC	High		X						
ND	Low			X				Study resolution passed but was not given priority. Currently on hold.	
OH	Low	X							Proposed bill in committee at end of session. Will be carried over to 1988 session. Attitude is "wait and see." Better to study issue than pass bills in haste.
OK	High	X	X	X				Law passed to have state regents for higher ed study developing a program to create at least one trust fund for tuition & fee prepayment. IRA-type proposal also being considered. Includes matching state funds for low income families.	

State	Level Of Interest	Type of Proposal				Other Proposals	Enacted Vetoed Underway	Study/Interim Committee	Comments
		Tuition Guarantee	Savings Program	Interim Studies	IRS Contingent				
OR	Moderate	X		X				Bill proposed & waiting for further study. May be interim studies on the issue in 11/87.	
PA	Moderate	X	X	X				Combines educational IRA with a guarantee plan. Committee continues to study the bill & recommendations.	
RI	High	X	X	X				Bill passed to establish commission to study issue; findings to be reported by 11/16/87. Growing interest in college savings bond approach.	
SC	Moderate	X						Bill did not get out of committee. Interim study of the issue.	
SD	Low								
TN	High	X			Yes ¹			Enacted 5/87; tuition prepayment plan. Will be implemented when IRS rules favorably. Scheduled for 7/88.	

State	Level Of Interest	Type of Proposal				Other Proposals	Enacted Vetoed Underway	Study/Interim Committee	Comments
		Tuition Guarantee	Savings Program	Interim Studies	IRS Contingent				
TX	Low	X		X				Bill proposed but tabled due to tax financial considerations. Interim study has been requested.	
UT	Moderate	X				Utah has produced a brochure entitled "Your Child's College Education, Invest in in Tomorrow. . .Today," that they disseminate in hospitals, day care centers, etc. Hope to encourage parents to save.			Board of regents was planning study of prepayment plans; study did not get priority. Bill reflecting tuition guarantee idea to be drafted for 1988 session.
VT	Moderate	X	X	X					Bill proposed but held over until 1/88. Committee studying state & federal alternatives & options. Should have results by mid-November.
VA	Low		X	X		Joint resolution for tax incentive savings plans for college ed was introduced 1/87 but failed. Bill will most likely be proposed in 1988.		State Council of higher ed involved in comprehensive study of higher ed finance. Study will include tuition prepayment plans. Will probably stay with the tuition savings bond approach rather than prepaid tuition.	

State	Level Of Interest	Type of Proposal				Other Proposals	Enacted Vetoed Underway	Study/Interim Committee	Comments
		Tuition Guarantee	Savings Program	Interim Studies	IRS Contingent				
WA	Moderate	X		X		Bill proposed but tabled until next year.		State higher ed loan authority studying options for savings incentive plans. Interim study by the standing committee on higher ed will be presented to legislature when it reconvenes.	
WV	High	X				Bill passed House & Senate. Was vetoed by Governor in 6/87. May be re-introduced next session.			
WI	Moderate							University regents tasked with preparing a study & legislative language by 11/88.	Primary concerns include fiscal and administrative problems.
WY	High	X			No	Enacted 2/87, contracts being accepted. Provides for advance payment of resident & non-resident tuition as well as room & board.			

Conducted by Aims C. McGuinness, Jr., Assistant Executive Director for Higher Education, and Jennifer Afton, Research Assistant, Education Commission of the States, 1860 Lincoln Street, Suite 300, Denver, CO 80295, 303-830-3600. Information gathered through telephone interviews with legislative staff in 50 states. This survey will be updated periodically. Some of the information may already be out-of-date.

¹The Michigan statute states explicitly that the trust cannot enter into contracts until a favorable IRS ruling is received. Other state statutes say that the board must solicit answers to appropriate ruling requests from the IRS and must make the status of those requests known before entering into a contract.

ILLINOIS

Title: Baccalaureate Savings Act, Public Act 85-0939

Type: Education Savings Bonds

Status:

- Certified December 1987
- Bonds were issued January 11, 1988
- Interest is state and local income tax free

Description: General obligation bonds that are designated, marketed and sold as General Obligation College Savings Bonds. Funds from these bonds may be used anywhere for anything, even for non-educational purposes.

Eligibility and Residency: Anyone may purchase — anyone may use.

Price: Denominations range from \$935 to \$3,500 each, with maturity occurring in 5-20 years.

Room and Board? Yes, since proceeds may be used for anything.

Incentives:

- Denominations are smaller than regular general obligation bonds.
- Bonus paid if proceeds are used for tuition at in-state institutions of higher education.
- Up to \$25,000 in proceeds will be exempt from being factored into state financial aid formulas
- Income tax exemptions

Financial Aid Considerations: See Incentives, above

Whose Risk? Primarily the purchaser's.

Portability: Complete portability

Military Time Served: Not applicable since proceeds may be used anytime after maturity.

Termination and Refunds: N/A

Transferability/Substitutions: N/A

Administrative: The Baccalaureate Trust Authority advises both the Director of the Bureau of the Budget and the Governor on all aspects of the bonds. Issuance of the bonds is directed by the Governor upon recommendation by the Director of the Bureau of Budget.

Other:

An important aspect of this program is the educational and marketing effort required to inform parents about the options available for financing a higher education and the need to save in advance.

The Illinois Board of Higher Education, with the assistance of the Illinois State Scholarship Commission is tasked with this, and will report on their program and progress before April 30, 1988.

Over \$90 million in college savings bonds were sold on January 11 and 12, 1988.

MICHIGAN

Title: Michigan Education Trust Act; also known as the Michigan Baccalaureate Education Student Trust (BEST), Public Act No. 316, Enrolled H.B. No 5505.

Type: Tuition Guarantee. This is the model for most other tuition guarantee plans.

Status:

- Approved December 1986
- Act will be repealed on January 1, 1989, if no contracts have been entered into by that time.
- No contracts will be entered into until the IRS allows interest to be tax exempt. If an unfavorable ruling is made, the board will present alternative recommendations to the legislature.
- Purchase price is state income tax exempt. Interest is state and local tax exempt.

Description: Two plans are offered:

Plan A: The purchaser is entitled to a refund of the original investment minus administrative costs.

Plan B: The purchaser is entitled to a refund of the original investment minus administrative costs plus interest earnings.

Both plans are good for guaranteed tuition at state institutions of higher education leading to a baccalaureate degree. However, a qualified beneficiary may also choose to attend a junior or community college first, or may ask for an appropriate refund after graduating from a 2-year state school.

Eligibility and Residency:

- Michigan residents may purchase the plan.
- A qualified beneficiary must be a state resident.

Price:

- Price is estimated to be between \$3,000 and \$8,000, depending upon the child's age at time of purchase and payment method.

Room and Board? No

Incentives:

- Guaranteed tuition.
- State and local tax incentives on interest and purchase price.
- Relatively low purchase price.

Financial Aid Considerations: Not addressed by this bill.

Whose Risk? Primarily the state's

Portability:

- A refund may be paid directly to an independent degree-granting institution in Michigan. The amount will not be less than the prevailing weighted average tuition cost at a state institution for the number of credit hours covered by the contract on the date of termination.

MICHIGAN con't

- No portability over state lines

Military Time Served: Not addressed in this bill.

Termination and Refunds:

Termination occurs when benefits have not been used within the time specified on the contract, and no other arrangements have been made. If neither the purchaser nor the qualified beneficiary nor their agents can be found after reasonable effort, the trust may retain that which would have been refunded.

Contracts may be terminated (with refund according to either Plan A or Plan B) when the qualified beneficiary: 1) dies; 2) is not admitted to a state institution of higher education; 3) certifies that he or she has been accepted by and will attend a Michigan independent degree-granting institution; 4) certifies that he or she has decided not to attend a state institution of higher education; or 5) if other circumstances occur, as determined by the trust or by contract.

Transferability/Substitutions:

- Purchasers or qualified beneficiaries may neither sell nor transfer their contracts to another without prior approval.
- Substitution, however, is permitted.

Administrative:

The trust is within the Department of Treasury, but functions independently of the State Treasurer. It is governed by a Board of Directors.

The Board may contract out for services necessary to manage and operate the trust.

Trust funds are not be be considered state monies, but they may be pooled with state assets for investment purposes.

Annual accounting, audits, and evaluations for actuarial soundness are required.

Other:

This law empowers the trust to study the feasibility of instituting prepayment plans between private sector investment managers, state institutions of higher education, and independent degree-granting schools.

The trust is also asked to study prepayment plans for junior and community colleges.

TENNESSEE

Title: Tennessee Baccalaureate Education System Trust Act, HB No. 618, Public Chapter No. 281

Type: Tuition Guarantee — Michigan Model

Status:

- Approved May 1987
- Contracts may not be entered into before July 1, 1988
- Trust income is state and local tax exempt.
- Status of IRS ruling requests must be made known by the board before entering into contracts.

Description: This law states simply that contracts for prepaid guaranteed tuition entered into between purchasers and the trust are good at any state institution of higher education which is defined as a "college or university established in Tennessee Code Annotated. . . or any institution of the University of Tennessee."

Eligibility and Residency:

- Purchaser's residency is not addressed in this bill.
- Qualified beneficiary must be a state resident.

Price: Not addressed in this bill.

Room and Board? No

Incentives:

- Guaranteed tuition
- State and local tax exemptions.

Financial Aid Considerations: Not addressed in this bill.

Whose Risk? Primarily the state's.

Portability: Not addressed in this bill.

Military Time Served: Not addressed in this bill.

Termination and Refunds: Not addressed in this bill.

Transferability/Substitutions.

- Contracts may not be sold or transferred without board approval.
- Substitutions are not addressed in this bill.

Administrative:

The trust will operate within the state treasury and will be administered by the state treasurer. It will be governed by the board of trustees.

The Tennessee Student Assistance Corporation will provide staff support to the board and the program.

The board will set investment policy.



ASSOCIATED STUDENTS OF KANSAS

The Student Governments of the State Universities

Suite 608 • Capitol Towers • 400 S.W. 8th St. • Topeka, Ks. 66603 • (913) 354-1394

Christine A. Graves
Executive Director

Mark E. Tallman
*Director of Legislative Affairs
and Development*

MEMBERS:

Associated Student Government
Emporia State University
Memorial Union
Emporia, Kansas 66801
316-343-1200 ext. 5494

Student Government Association
Fort Hays State University
Memorial Union
Hays, Kansas 67601
913-628-5311

Student Governing Association
Kansas State University
Student Union
Manhattan, Kansas 66506
913-532-6541

Student Government Association
Pittsburg State University
Student Union
Pittsburg, Kansas 66762
316-231-7000 ext. 4813

Student Senate
University of Kansas
Burge Union
Lawrence, Kansas 66045
913-864-3710

Student Government Association
The Wichita State University
Campus Activities Center
Wichita, Kansas 67208
316-689-3480

TO: House Committee on Taxation
FROM: Mark Tallman, Legislative Director
DATE: March 1, 1988

RE: HB 2877 - Tax Deductions for Educational Savings Plans

Position

ASK supports the concept of HB 2877.

Background

In the past several years, one of the most talked-about issues by state higher education policy-makers has been encouraging families to save for college. This interest has been prompted by rapid increases in tuition across the nation, and growing concern by parents on how to meet those college costs. Because this trend is also true in Kansas, ASK has prepared a report on this issue and initiatives in other states. That report accompanies this statement.

In the report, we identify four major approaches to college savings programs. The first, Prepaid Tuition, was also the first kind of program to be adopted by any state. Such plans have been approved by Florida, Indiana, Maine, Michigan, Tennessee and Wyoming.

The second approach, publicly-administered Education Trust Accounts, has been introduced by Representatives Bowden and Hassler in HB 2876, which will receive a hearing today in the House Education Committee.

The third approach, private-sector Individual Education Accounts, is encompassed in the bill before you today, HB 2877.

The fourth approach, zero-coupon education savings bonds, may be introduced in the Senate.

It is our hope that the Legislature will favorably consider one or more of these approaches, or at least request an interim study of their relative merits.

Why is this issue important to Kansas?

REASONS TO SUPPORT COLLEGE SAVINGS PROGRAMS

1. Costs of attending the state universities, especially tuition, have exceeded inflation in recent years, as the first chart on the following page shows. Although "tuition inflation" has slowed in the past year or two, the Regents' Margin of Excellence program relies to a significant degree on tuition for its financing, and higher tuition is projected for the next several years.

2. "Traditional" financial aid programs are not keeping up with college costs. The second chart on the following page compares increases in full-time, resident tuition at the state universities with average per student awards in the major federal student aid programs. (These are national averages; we are currently compiling this data for the state universities.)

The chart on the next page shows when and how college costs can be paid, as well as problems associated with each area. Because the factors that limit the means to pay "during" college (i.e. federal and state budget constraints and low minimum wages) are unlikely to change significantly; and because excessive borrowing to pay "after" college is considered undesirable by both many individuals and economists, prior savings is one of the few alternatives.

3. Few incentives currently exist to encourage and assist families in saving for college. Of course, the savings rate in general has fallen in this country. Many families do not know how much college costs really are, or how much they will be at any point in the future. There are no special tax benefits for college savings, unlike retirement, for example. Finally, low- to middle-income families may be unsophisticated about investments, and rely on passbook accounts that do not keep pace with college costs.

ADVANTAGES OF HB 2877 FOR COLLEGE SAVINGS

1. It provides a tax incentive for college savings, an advantage not currently provided. This would probably be most attractive to middle-income families who are not eligible for many need-based student aid programs.

2. Establishing such a deduction will create greater awareness of the need for college savings; stimulating families to better planning.

3. The program would be developed and marketed by private institutions; which means that no state dollars would be spent on administration of accounts under the program.

4. The program would be open to students who wish to attend any type of postsecondary program.

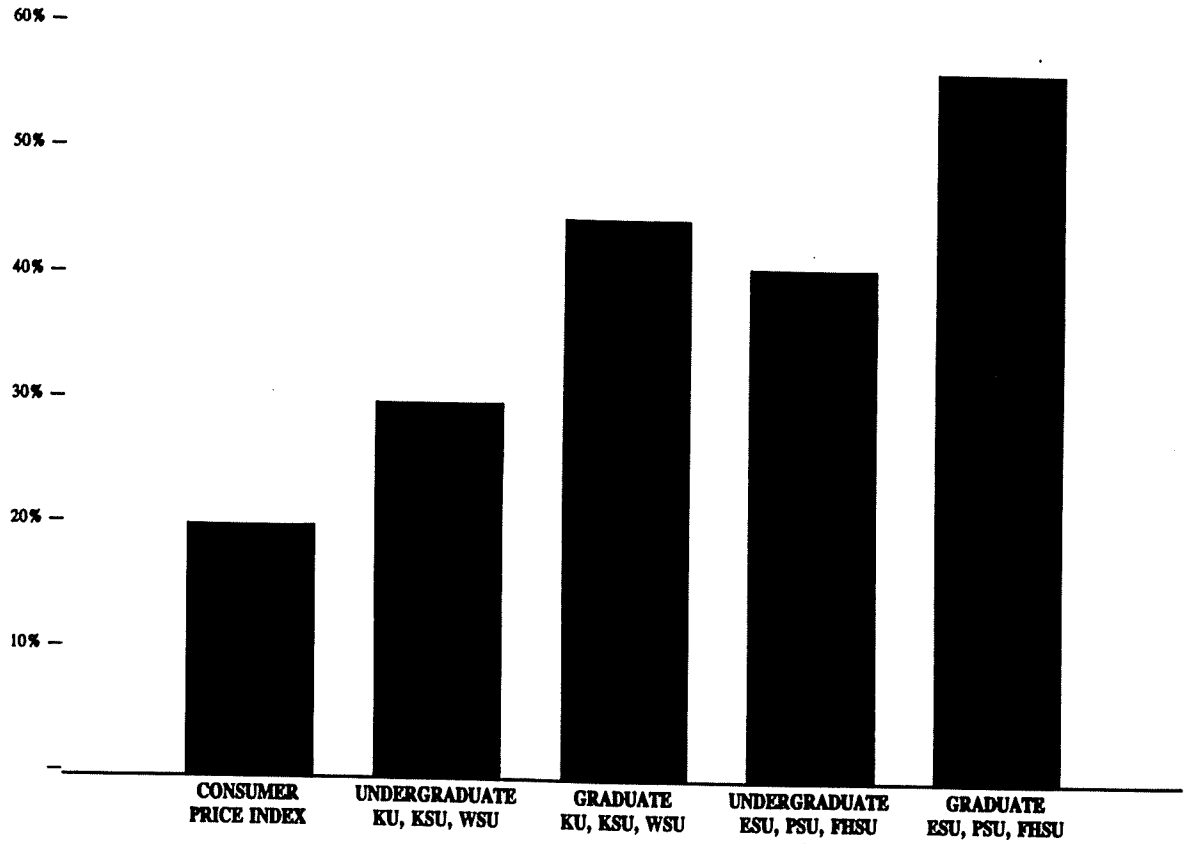
5. The program would assist both families saving for their children and individuals saving for their own continuing education.

Conclusion

A college education has become an important goal for many Kansans. There has been much discussion recently about restricting admission at the state

RISING COSTS:

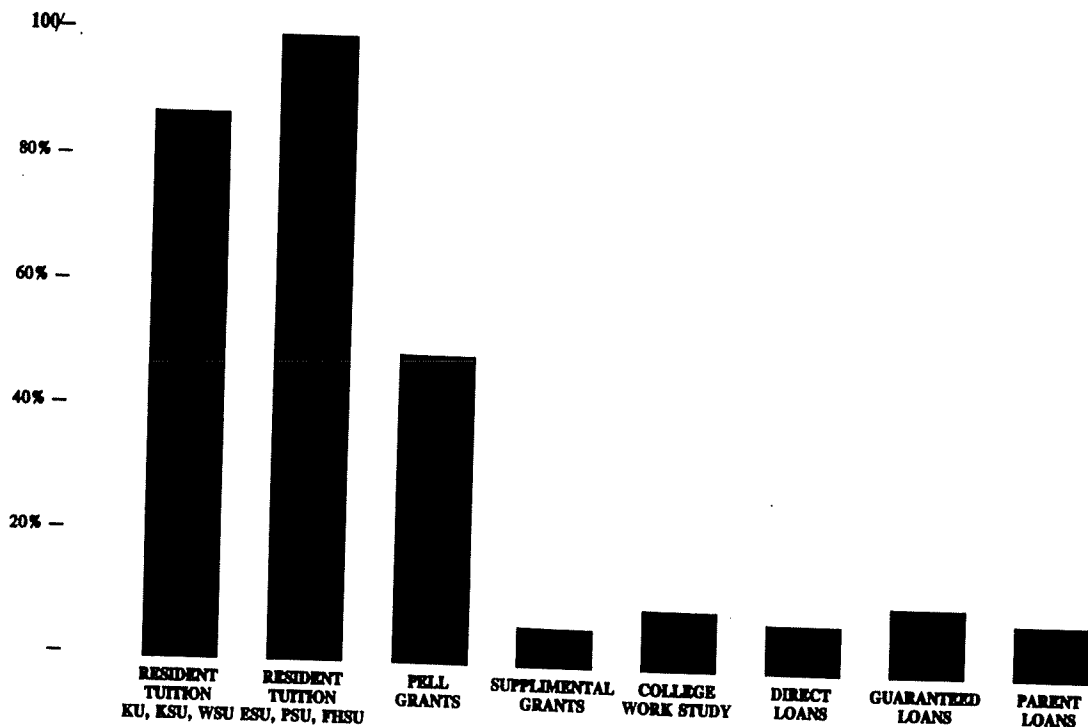
RESIDENT TUITION INCREASE, FY 83 - FY 88, COMPARED TO CONSUMER PRICE INDEX INCREASE



Source: Kansas Board of Regents

NOT KEEPING UP:

INCREASE IN AVERAGE PER STUDENT AWARDS IN FEDERAL STUDENT AID PROGRAMS, COMPARED TO RESIDENT TUITION INCREASES, FY81-FY87



Source: Kansas Board of Regents, College Board Survey

WHEN AND HOW A COLLEGE EDUCATION IS PAID FOR

<u>When</u>	<u>How</u>	<u>Problems</u>
Before:	Personnel Wealth	Limited to the wealthy
	Savings	Lack of incentives and understanding Need to keep up with tuition
During:	Scholarships	Not widely available
	Grants	Funding hasn't kept up with costs
	Jobs	Funding hasn't kept up with costs Wages haven't kept up with costs
After:	Loans	Concerns over excessive borrowing Repayment difficult in low salary professions

universities, and the impact on individual opportunity. Views may differ on that question, but admission is meaningless to those who cannot afford the bill.

This bill retains a major responsibility in paying for college with families and individuals. But by adopting this bill, the state would assist them in meeting those responsibilities.

Thank you for your consideration.



ASSOCIATED STUDENTS OF KANSAS

The Student Governments of the State Universities

Suite 608 • Capitol Tower • 400 S.W. 8th St. • Topeka, Ks. 66603 • (913) 354-1394

COLLEGE SAVINGS AND PREPAID TUITION

A Report on Policy Options

September, 1987

MEMBERS:

Associated Student Government

Attachment 3

Student Government Association

for Iowa State University

Governing Association
of Kansas State University

Student Government Association
Pittsburg State University

Student Senate
University of Kansas

Student Government Association
The Wichita State University

The Issue

Should the state do more (by adopting new policies or programs) to encourage or assist families in accumulating resources to pay for college costs? If so, what steps are appropriate?

Introduction

Within the past year, the issue of paying for college has become a major topic in higher education and government. Proposals to help families confront college costs have prompted legislative attention in many states. Several states, led by Michigan, have already enacted programs which will allow parents to "prepay" tuition for their children years in advance, thus locking in at current (or even discounted) prices. At the national level, Education Secretary William Bennett has endorsed the concept of college savings programs, and several Presidential candidates have made college access a campaign theme.

The private sector has also shown interest in addressing the issue. This month a new financial institution called the College Saving Bank opened for business and began offering FDIC-insured certificates of deposit that the bank guarantees will appreciate as rapidly as increases in the average cost of a private college.

In order to recommend policy on behalf of the Associated Students of Kansas, a study was conducted to answer the important questions posed by this issue.

To accomplish this, University of Kansas Campus Director Martie Aaron compiled extensive files on bills and proposal in other states. ASK Executive Director Chris Graves attended an invitational conference on this topic in Denver, July 7-8, sponsored by the Education Commission of the States, the College Board, the American Council on Education, and the Forum on College Financing Alternatives. This report was written by ASK Legislative Director Mark Tallman, with information they collected.

This study is reported in the following manner.

First, we review the basic environmental factors influencing the discussion nationally. Then we examine whether or not these factors are present in Kansas to determine if there are compelling needs to be addressed by public policy initiatives.

Second, we look at the general policy goals the proposals under consideration in various states seem to share. Then we review four major approaches to addressing the family college financing problem.

Third, we offer recommendations for Kansas policy in this area.

Reasons for Growing Interest in College Savings and Financing Programs

1. The rapid increase in college tuition costs.

For the past seven years, average tuition charges for both public and private colleges have increased faster than inflation.(1) Between 1980 and 1984, tuition at private colleges rose 56% and at public colleges 49%, while family incomes rose by only 26%.(2)

Over a longer period, tuition outpaced inflation by 2 1/2 percent between 1965 and 1985.(3) It now costs an average of over \$20,000 to finance a four-year college education. If tuition continues to outpace inflation and family income, a growing percentage of families may simply be priced out of a college education.

2. A decline in federal student assistance, especially for middle income students.

In the 1970's, federal student aid was expanded significantly to promote educational opportunity. In the 1980's, under constant pressure from the Reagan administration to reduce spending, awards in every major federal financial aid program lost value in real terms - at a time when college tuition was increasing in real terms.(4)

Congress last year also made changes in the Guaranteed Student Loan Program. Once the major federal program designed to assist middle-income families, eligibility guidelines have been tightened to a point that families with incomes as low as \$26,000 are excluded. Some universities report that up to 50% of student loan recipients have had their loans reduced or eliminated.(5)

3. A shift in financing from government grants and parental assistance to potentially excessive student loans.

The means of financing college education have fluctuated over the decades. In the 1930's, families paid about two-thirds of total colleges costs (including living expenses.) Of course, far fewer families could afford to send children to college. To expand educational opportunities, state governments increased aid to state institutions, and the federal government created aid programs for both colleges and students. As a result, the share of costs born by families has fallen to one-third, with state governments picking up another third and the federal government and philanthropy paying the rest.(6)

In recent years, however, college costs have risen faster than state and federal aid, as well as family income. To meet these costs, many students have turned to borrowing to finance their education. Between 1978 and 1985, total student loan indebtedness under federally-insured programs rose by 390%. At the same time, total consumer installment credit outstanding rose only 104%.(7) The Education Commission of the States reports "Evidence suggests that increasing student indebtedness is having negative effects both on who goes to college and on student selection of majors and careers."

4. A lack of public information on college financing.

Attention to these issues by the media and political leaders has probably contributed to public confusion over college costs. A survey by The Chronicle of Higher Education (Sept. 2, 1987) showed that 24% of respondents said they didn't know what a year at a four-year public university would cost. Of those who thought they did know, the average guess was \$9,120 - far above the actual national average of \$5,789. They also thought the typical family would be willing to pay \$6,120 - more than college actually costs on the average, but well below what respondents thought it cost.

5. A lack of incentives for accumulating resources.

The government, primarily through its tax policies, has encouraged families to "plan ahead" for certain expenses. Examples are Individual Retirement Accounts, pension plans, and life and health insurance, which all receive favorable tax consideration. No similar consideration is provided for education savings. Also, many low- to middle-income families lack the knowledge and confidence for investment, so most savings will be in bank accounts which are unlikely to grow as fast as college expenses. Finally, smaller savings accounts generally provide lower yields.

6. Concern in many states about "brain drain"; the out-migration of students.

Although this concern is not tied directly to tuition costs, the goal of keeping top students in state for college is widespread. A significant number of states have established or expanded "merit" scholarship programs, which provide substantial grants to high-achieving students who attend college in their home states.

General Policy Goals

Several goals seem common to most college financing plans which have been adopted or proposed.

1. To inform families about college expenses and how to finance them.

Almost every proposal stresses the importance of publicity and awareness. One argument in favor of such plans is that the very existence of such a program calls public attention to the issue.

2. To provide mechanisms to encourage and assist in saving for college.

The programs try to offer one or more of the following "advantages" not presently available:

- a. Assurance.

Prepaid tuition plans offer a guarantee that invested savings will keep pace with tuition at designated institutions.

- b. Tax Benefits.

Many plans attempt to offer some tax benefit, especially on accumulated interest earnings. However, the tax consequences of many aspects of these plans is still unclear. The Michigan plan, which is the most well-known and copied plan, is still not implemented in that state, pending a ruling by the IRS.

- c. Simplicity.

To assist families without investment experience, such plans are a vehicle to meet a single, specific goal - paying for college - unlike life insurance, stocks and bonds, etc.

- d. State Endorsement.

Unlike private sector investment, these plans carry the full backing of the state government, and are also dedicated to a specific public policy objective.

3. To encourage attendance at institutions within the state.

Almost every plan is structured to provide incentives for the student to attend college in the state.

Major Approaches to College Savings Plans:

I. Prepaid Tuition

Overview - A state authority attempts to forecast future tuition levels. It then offers "prepaid tuition contracts" for specified future years. It will then pool and invest receipts with the goal of earning income adequate to "pay out" the amount of tuition when the contract becomes due.

There are two major subdivisions of this category. Under the first, participation is limited to institutions with similar tuition levels, such as members of a university or community college system, and the student can redeem the prepaid contract only at one of those institutions. (This is the Michigan Plan.) Under the second approach, the contract takes the form of a "certificate." These certificates may be redeemed at any participating institution, but the "exchange rate" will vary depending on cost. For examples, a \$100 certificate might prepay four credit hours at a community college, two credit hours at a state university, and one credit hour at a private college.

Administration - A new board or trust would be established either independently or associated with an existing agency. It would probably be managed along the lines of a public retirement system, which must pay out a fixed benefit at a fixed time. Very simply, it would be responsible for assuring that invested funds appreciate at a rate equal to tuition.

Price or Cost of Participation - The Board would establish the cost of each contract or certificate. For the purchase of a full contract, installment financing could be provided, although this would of course increase the total cost. One advantage of the certificate approach would be to allow the purchase of small denominations or units, which could be marketed as gifts, etc.

Refundability - If only principle can be refunded, appreciation would probably not be taxable. If principle and appreciation is refundable, it probably would be taxable. Several state programs offer both refund options.

Incentives to Participation - Provides a guarantee to parents. By providing for installment purchase or use of certificates, the cost of participation is lowered. Depending on the IRS tax ruling, interest earnings might be tax exempt, especially for non-refundable plans.

Disincentives to Participation - The simplest plan is a one-time payment guaranteeing tuition at one institution or system. However, this requires a significant "up front" payment, and limits choice. The use of installment payments and certificates complicates the plan. Parents may be reluctant to invest if funds cannot be withdrawn if students do not attend college in Kansas.

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Advantages to the State -- It encourages parents to save for college, and may help ease the need for student borrowing. It promotes enrollment in Kansas if restricted to Kansas institutions, and if withdrawals are penalized.

Disadvantages to the State -- It requires administration of a new program. The state assumes the risk if invested funds do not appreciate enough to cover tuition. If refunds are allowed, families could use the program as an investment vehicle, then withdraw funds for use elsewhere. The state would then be competing with private investment programs.

Activity in Other States -- Michigan, Maine, Tennessee and Wyoming have all enacted similar prepaid tuition plans, but none have been implemented pending a ruling on tax issues by the IRS.

Indiana and Florida also have enacted such programs, and are proceeding without a tax ruling. Both feature an option to prepay tuition for two-year programs.

The Florida and Wyoming plans also allow pre-payment of room and board costs.

ECS also reports "high" levels of discussion on such plans in California, Georgia, Illinois, Louisiana, Maryland, Minnesota, New Jersey, Oklahoma and West Virginia.

Major Approaches to College Savings Programs:

II. Education Trust Accounts (Publicly Administered)

Overview - This plan is similar to prepaid tuition plans with two exceptions. First, there is no pre-payment which "guarantees" a specific amount of tuition. Second, contributions are open-ended. Essentially, this plan is a state-administered pooled savings program, which offers families and individuals an easy way to set aside funds. Higher yields are possible due to a larger pool of funds, low overhead, non-profit status, and limitations on withdrawals.

Administration - As under a prepaid tuition plan, a new board or trust would be established either independently or associated with an existing agency. It too would probably be managed like a public retirement system, but perhaps more along the lines of a college endowment, which does not have to achieve a specific return for each pension account.

Price or Cost of Participation - In general, any amount could be accepted at any time, although for efficiency, some restrictions on amounts and frequency of deposits might be imposed. This type of plan could also attract employer payroll contributions, gifts and scholarships, which would be deposited in the individual's account.

Refundability - The accounts could be offered in two types. Deposits could be withdrawn from type I accounts, but with a substantial penalty and most likely subject to tax. Type II accounts would be tapped only if the student enrolled at an eligible institution, and withdrawals would be sent directly to the institution. Hopefully, appreciation under this plan would not be taxable. Non-refundable plans would also assure non-family contributors that their contribution would only be used for college expenses.

Incentives to Participation - This plan provides the least complicated way of stimulating and pooling college savings, especially for those with the fewest resources. Such individual education accounts would also offer an attractive means for business and charities to promote education by assisting individuals. The accounts could earn somewhat higher yields, and would hopefully receive favorable tax treatment. The widest range of institutions could be made eligible, offering the student maximum choice.

Disincentives to Participation - This approach does not offer a tuition price guarantee, and therefore may not seem a compelling reason for families to increase savings.

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Advantages to the State - It would encourage college savings by families and individuals, and may help ease the need for student borrowing. It promotes enrollment in Kansas if penalties are imposed for attending an out-of-state school. The state does not assume the financial risk of "guaranteeing" to cover tuition. Because funds would be available at any time, it would also assist older students saving for themselves.

Disadvantages to the State - It requires administration of a new program. If refunds are allowed, it may be seen as simply an alternative investment vehicle, with the state competing with private banks and savings institutions.

Activity in Other States - This concept was proposed in Pennsylvania, along with a prepaid tuition plan. It would allow individuals to establish trust accounts, with the option to "prepay" after enough funds are accumulated.

Major Approaches to College Savings Programs:

III. Individuals Education Accounts (Privately Administered)

Overview - This plan is similar to publicly administered Education Trust Accounts, with one major exception: participating families or individuals would establish such accounts with private sector institutions rather than a public fund. In this sense, it would operate very much like an Individual Retirement Account. The state could establish certain tax benefits along the lines of IRAs.

Administration - The only significant state involvement would be in modifying the tax code. The administration, promotion and marketing would be left to private institutions.

Price or Cost of Participation - These features would be determined by the private financial institutions, and by limits on tax benefits adopted by the state.

Refundability - As with IRAs, any withdrawal of funds for use other than to finance a college education would result in penalties or negative tax consequences.

Incentives to Participation - The only advantage this plan has over the status quo would be certain tax benefits.

Disincentives to Participation - The tax benefits would probably be relatively minor, because only state tax liability would be modified. It is unlikely such plans could reduce federal taxes without a change in the federal tax code. The plan offers little benefit to the lower income levels.

Advantages to the State - It does not require any new administrative costs. It would encourage college savings by families and individuals, and could promote enrollment in Kansas if there is a penalty imposed for attending an out-of-state school. Because the funds would be available at any time, it would assist older students saving for themselves.

Disadvantages to the State - It would result in a loss of revenue if significant tax benefits are provided.

Activity in Other States - Such a plan has been proposed in Missouri. This concept has also been proposed at the national level by Kansas Sen. Robert Dole, and others.

Major Approaches to College Savings Programs

IV. Education Savings Bonds

Overview - The state would issue general obligation bonds in the form of zero coupon college savings bonds with a maturity of 1 to 20 years. Parents could buy bonds maturing when their child reaches college age. The proceeds from the bonds could be used for on-going capital needs. (For example, at the state universities) An additional bonus payment could be made upon certification that a child had enrolled at an in-state institution.

Administration - Once an appropriate authority issued the bonds, they could be marketed through existing channels of banks and/or brokers. The marketing emphasis would be placed on families wanting a savings plan for college expenses.

Price or Cost of Participation - The bonds should be offered in units as small as possible; i.e. \$500 or less.

Refundability - Would be treated as other bond issues.

Incentives to Participation - Provides a simple investment vehicle for college savings, with a potentially higher yield. Appreciation would probably be tax exempt. The bonds could finance any savings program, including college costs.

Disincentives to Participation - The bonds may be somewhat high in price for lower-income families. If the yield does not fluctuate, a family may make its initial purchase when yields are low. Some families may be intimidated by making bond purchases.

Advantages to the State - It encourages families to save for college. The bonds would provide some long term financing for state needs. It promotes enrollment in Kansas if a bonus is paid for attending college in the state.

Disadvantages to the State - State assumes responsibility for retiring the bonds. This method may result in increased advertising and underwriting costs for marketing and use of smaller denominations than would occur with larger units.

Examples in Other States - Final approval of such a concept is close in Illinois and North Carolina.

This concept has been advocated at the national level by Vice President and Presidential Candidate George Bush.

Recommendations

1. A state controlled or "authorized" program to pool and invest funds in individual education accounts should be established.
 - a. These accounts could be opened by individuals for themselves or their children/dependents. These accounts should not be used only for parental contributions on behalf of children approaching traditional college age, but for the lifelong use of persons who may seek additional post-secondary education.
 - b. Such accounts could receive both parental contributions and student contributions from employment. Funds in this portion of the accounts could be set up so that withdrawals for other purposes would be allowed; probably with a substantial penalty. Interest earnings under such a plan would probably be taxable.
 - c. Policies should also be developed to encourage contributions from employers as well as scholarships from other sources. This portion of the account should probably be non-refundable: that is, it could only be used when a student actually enrolls in an eligible institution, with funds sent directly to the institution. Under this provision, contributors would know that their contribution could only be used to meet educational expenses. Unused funds could eventually revert into a general scholarship fund. Hopefully, these interest earnings would not be taxed.
2. The state should consider giving tax incentives to individuals and families who save funds which are used to meet college expenses.
3. The state should also explore the use of low denomination zero-coupon college savings bonds if a bond authority is provided.

Notes

1. Source: Chronicle of Higher Education report on College Board annual survey
2. Michael S. McPherson and Mary S. Skinner, "Paying for College: A Lifetime Proposition," The Brookings Review, Fall 1986
3. Richard Anderson, Change March/April 1987
4. Source: The Condition of Education, Center for Education Statistics, 1986 Edition.
5. Source: Chronicle of Higher Education, Sept. 9, 1987
6. McPherson
7. Source: Janet Hansen, Student Loans: Are They Overburdening A Generation?, U.S. Congress Joint Economic Committee, 1986