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DATE: April 2, 2001

**HOUSE OF REPRESENTATIVES
COMMITTEE ON
COMMITTEE ON COLLEGES & UNIVERSITIES
ANALYSIS**

BILL #: HB 1547
RELATING TO: Florida Prepaid College Program
SPONSOR(S): Representative(s) Kottkamp

TIED BILL(S):

ORIGINATING COMMITTEE(S)/COUNCIL(S)/COMMITTEE(S) OF REFERENCE:

- (1) COMMITTEE ON COLLEGES & UNIVERSITIES
 - (2) EDUCATION APPROPRIATIONS
 - (3) COUNCIL FOR LIFELONG LEARNING
 - (4)
 - (5)
-

I. SUMMARY:

This bill changes the definition of "purchaser" for purposes of the Florida Prepaid College Program to mean, "a person who, or an entity that, makes or is obligated to make advance registration or dormitory residence payments in accordance with an advance payment contract." Representatives of the Prepaid Program indicate that because the current definition of "person" for purposes of the Prepaid Program is very broad (see s. 1.01, F.S.), the proposed change is unnecessary. They suggest that the proposed change may not have the effect of broadening who can buy a contract and could have the opposite effect.

The bill authorizes any nonprofit organization exempt from taxation under 26 U.S.C. s. 501(c) to purchase advance payment contracts for scholarships and allows such contracts to omit the name of the qualified beneficiary. Representatives of the Prepaid Program have expressed concern that this provision conflicts with federal law relating to qualified state tuition programs and could jeopardize the Prepaid Program's tax exempt status under s. 529, Internal Revenue Code.

The fiscal impact of a loss of the Prepaid Program's tax-exempt status on the Prepaid Program, contract purchasers, and beneficiaries is indeterminate.

II. SUBSTANTIVE ANALYSIS:

A. DOES THE BILL SUPPORT THE FOLLOWING PRINCIPLES:

- | | | | |
|-----------------------------------|------------------------------|-----------------------------|---|
| 1. <u>Less Government</u> | Yes <input type="checkbox"/> | No <input type="checkbox"/> | N/A <input checked="" type="checkbox"/> |
| 2. <u>Lower Taxes</u> | Yes <input type="checkbox"/> | No <input type="checkbox"/> | N/A <input checked="" type="checkbox"/> |
| 3. <u>Individual Freedom</u> | Yes <input type="checkbox"/> | No <input type="checkbox"/> | N/A <input checked="" type="checkbox"/> |
| 4. <u>Personal Responsibility</u> | Yes <input type="checkbox"/> | No <input type="checkbox"/> | N/A <input checked="" type="checkbox"/> |
| 5. <u>Family Empowerment</u> | Yes <input type="checkbox"/> | No <input type="checkbox"/> | N/A <input checked="" type="checkbox"/> |

For any principle that received a "no" above, please explain:

B. PRESENT SITUATION:

Florida Prepaid College Program

Section 240.551, F.S., creates the Florida Prepaid College Program which allows the purchase of advance payment contracts for a student's postsecondary education that lock in the cost of registration fees, local fees, and housing at the time the contract is purchased. The Prepaid Program was created in 1987 to help Florida families save for college. To qualify, the child must be a Florida resident, newborn through the 11th grade. Enrollment in the Prepaid Program takes place from October through January each year.

The Prepaid Program offers the following plans: a 2-year community college plan; a 4-year university plan; a 2+2 community college/university plan; a dormitory plan; and a local fee plan. A plan can be used at any of Florida's 10 state universities and 28 community colleges and select technical schools statewide. The value of a plan may be transferred to an accredited independent college or university that is located and chartered in Florida, that is not for profit, and that confers certain degrees. The value of a plan may also be transferred to an accredited out-of-state college or university that is not for profit and that confers degrees.

If a beneficiary enrolls in a state postsecondary institution, the Prepaid Program pays for registration fees, local fees, or housing costs as covered in the beneficiary's advance payment contract. If a beneficiary enrolls in an eligible Florida independent institution, the Prepaid Program transfers to that institution an amount not to exceed the redemption value of the advance payment contract at a state postsecondary institution. If a beneficiary enrolls in an eligible out-of-state college or university, the Prepaid Program transfers to that institution an amount not to exceed the redemption value of the advance payment contract or the original purchase price plus five percent compounded interest, whichever is less.

Current law is very inclusive when defining who may purchase an advance payment contract. Section 240.551(2)(e), F.S., defines "purchaser" to mean "any person who makes or is obligated to make registration or dormitory payments in accordance with an advance payment contract." In the absence of any language restricting the definition of the term "person" as used in the definition of the term "purchaser", the definition of the term "person" is that set forth in s. 1.01(3), F.S., which provides that the term "person" includes individuals, children, firms, associations, joint adventures, partnership, estates, trusts, business trusts, syndicates, fiduciaries, corporations, and all other

groups or combinations. According to the Florida Prepaid College Board there are over 600,000 existing contracts with a wide spectrum of purchasers – parents, grandparents, corporations, partnerships, trusts, guardianships, and estates.

Section 240.551(11)(e), F.S., provides that except for an advance payment contract entered into pursuant to subsection s. 240.551(22), F.S., the name of the qualified beneficiary and terms under which the beneficiary may be changed must be set forth at the inception of the contract. Section 240.551(22), F.S., authorizes the Prepaid Board to establish a direct-support-organization. That direct-support organization is the Prepaid College Foundation. The direct-support-organization is organized and operated, exclusively to receive, hold, invest, and administer property and to make expenditures to or for the benefit of the Prepaid Program. One of the duties of the Prepaid Foundation is to administer the Florida Prepaid Tuition Scholarship Program.

Qualified State Tuition Program

Section 240.551(8), F.S., grants the Prepaid Board the authority to adopt rules “. . . necessary to enable the program to retain its status as a ‘qualified state tuition program’ in order to maintain its tax exempt status or other similar status of the program, purchasers, and qualified beneficiaries under the Internal Revenue Code of 1986, as defined in s. 220.031(1), F.S.”

Section 529 of the Internal Revenue Code defines “qualified State tuition program” to mean “a program established and maintained by a State or agency or instrumentality thereof under which a person may purchase tuition credits or certificates on behalf of a designated beneficiary which entitle the beneficiary to the waiver or payment of qualified higher education expenses of the beneficiary”

The term “designated beneficiary” is defined in section 529(e), Internal Revenue Code, as:

- The individual designated at the initiation of the contract
- The new beneficiary if the beneficiary has been changed in accordance with the provisions of s. 529 and s. 240.551, F.S.
- The individual receiving the interest, or benefit, as a scholarship.

Section 529(e)(1)(C), Internal Revenue Code, provides that the third definition of a “designated beneficiary” is only valid “in case of an interest in a qualified State tuition program purchased by a State or local government (or agency or instrumentality thereof) or an organization described in section 501(c)(3) and exempt from taxation under section 501(a) as part of a scholarship program operated by such government or organization . . .”

Under the guidelines of section 529, Internal Revenue Code, if any other type of organization, other than one described in section 501(c)(3), exempt from taxation under s. 501(a), and operating a scholarship program, purchases an advanced payment contract, the beneficiary must be named at the inception of the contract.

Representatives of the Prepaid Board identify three major tax benefits of being a qualified state tuition program (QTSP) as identified in Section 529 of the Internal Revenue Code:

1. The Florida Prepaid College Program is exempt from taxation under Section 529.
2. Contributions to a QTSP on behalf of a designated beneficiary receive gift tax treatment under section 2503(b), Internal Revenue Code.

3. Any distribution of a QTSP is taxable for the beneficiary. The tax advantage of this is that the contract earnings are taxed at the tax rate of the beneficiary (the student) rather than the purchaser.

Florida Prepaid Tuition Scholarship Program

Section 240.552, F.S., establishes the Florida Prepaid Scholarship Program with the intent to provide economically disadvantaged youth with prepaid postsecondary tuition scholarships. The direct-support-organization established pursuant to s. 240.551, F.S., administers the program with assistance and cooperation of the Department of Education.

The program was initiated to:

- Provide an incentive for economically disadvantaged youth to improve school attendance and academic performance in order to graduate and pursue a postsecondary education.
- Obtain the commitment and involvement of private sector entities by virtue of funding matches with a ratio of 50 percent provided by the private sector and 50 percent provided by the state.
- Purchase prepaid tuition scholarships for students certified by the Department of Education to the direct-support-organization who meet minimum economic and school requirements and remain drug free and crime free.

Project STARS, a program under the Prepaid Tuition Scholarship Program, is one such program that raises private money in order to receive matching money to purchase prepaid scholarships through the Prepaid Foundation.

Additionally, any organization may purchase scholarships through the Prepaid Foundation without naming a beneficiary. An organization may donate money to the Prepaid Foundation. The Prepaid Foundation, pursuant to section 529(e)(1)(C), Internal Revenue Code, may purchase advanced contracts and hold them in the name of the organization. The organization may define the scholarship requirements for their recipient if the organization does not wish to seek matching money. Additionally, purchasing scholarships through the Prepaid Foundation allows greater flexibility as one may purchase from the Prepaid Foundation at any time during the year as opposed to only during open enrollment. If a scholarship is awarded and the recipient is named but then chooses not to go to college, the scholarship stays in the name of the organization.

The recipient of any scholarship must meet the general requirement of an eligible beneficiary as defined in s. 240.551(2)(f), F.S.

C. EFFECT OF PROPOSED CHANGES:

This bill changes the definition of a purchaser for purposes of the Prepaid College Program to mean "a person who, or an entity that, makes or is obligated to make advance registration or dormitory residence payments in accordance with an advance payment contract."

This bill authorizes any nonprofit organization exempt from taxation under 26 U.S.C s. 501(c) to purchase advance payment contracts for scholarships. Such contracts may omit the name of the qualified beneficiary. Currently, only the Prepaid Foundation is allowed to purchase contracts without naming the beneficiary.

Representatives of the Prepaid Program expressed the following concerns regarding the proposed legislation:

- The change to the definition of a purchaser is unnecessary and may have a limiting effect rather than expansive effect on who can buy a prepaid scholarship. The current definition of a purchaser includes the term person. The definition of the term person in s. 1.01, F.S., applies. That definition includes natural persons, corporations, partnerships and other type of organizations. This interpretation is reflected in rule 19B-5.004, FAC, which provides “any person, corporation, or organization may purchase an advance payment contract for a qualified person.” At present there are a number of contracts the Board has sold where the purchasers are corporations, partnerships, and estates. HB 1547 may not have the effect of broadening who can buy a contract; it may have the opposite effect.
- Section 529 under the Internal Revenue Code defines a qualified state tuition program as “a program . . . under which a person may purchase tuition credits or certificates on behalf of a designated beneficiary which entitle the beneficiary to the waiver of payment of qualified higher education expenses...” Section 529 thus clearly requires a beneficiary to be named at the time of purchase of a prepaid contract, therefore HB 1547 would violate federal law.

In addition to the requirements relating to a beneficiary of a prepaid contract, s. 529(e)(1)(C) provides that the term “designated beneficiary” means “in the case of an interest in a qualified tuition program purchased by a state or local government (or agency or instrumentality thereof) or an organization described in section 501(c)(3) and exempt from taxation under section 501(a) as a part of a scholarship program operated by such government or organization, the individual receiving such interest as a scholarship.” In summary, this part of section 529 allows the Prepaid Foundation to buy a scholarship and name the beneficiary at a later date.

- The Florida Prepaid College Foundation is a direct-support-organization to the Florida Prepaid College Program, as authorized by s. 240.551(22), F.S. Currently, the entity buying the scholarship has to be the state, a local government, or a 501(c)(3) organization and the purchase has to be part of a scholarship program. HB 1547 only requires that the organization be a 501(c) organization and that it purchase contracts for scholarships. HB 1547 does not require the organization to be a 501(c)(3) organization nor does it require the organization to operate a scholarship program. Consequently, the Florida Prepaid College Program is concerned that if HB 1547 should become law it might imperil the programs tax exemption under s. 529.

D. SECTION-BY-SECTION ANALYSIS:

This section need be completed only in the discretion of the Committee.

III. FISCAL ANALYSIS & ECONOMIC IMPACT STATEMENT:

A. FISCAL IMPACT ON STATE GOVERNMENT:

1. Revenues:

See FISCAL COMMENTS.

2. Expenditures:

See FISCAL COMMENTS.

B. FISCAL IMPACT ON LOCAL GOVERNMENTS:

1. Revenues:

N/A

2. Expenditures:

N/A

C. DIRECT ECONOMIC IMPACT ON PRIVATE SECTOR:

See FISCAL COMMENTS.

D. FISCAL COMMENTS:

Representatives of the Prepaid Program suggest that the provisions of HB 1547, if enacted, could jeopardize the tax-exempt status of the program. The fiscal impact of the loss of the tax-exempt status on the Prepaid Program as well as purchasers and contract beneficiaries is unknown.

IV. CONSEQUENCES OF ARTICLE VII, SECTION 18 OF THE FLORIDA CONSTITUTION:

A. APPLICABILITY OF THE MANDATES PROVISION:

This bill does not require counties or municipalities to spend funds or take an action requiring the expenditure of funds.

B. REDUCTION OF REVENUE RAISING AUTHORITY:

This bill does not reduce the authority that municipalities or counties have to raise revenues in the aggregate.

C. REDUCTION OF STATE TAX SHARED WITH COUNTIES AND MUNICIPALITIES:

This bill does not reduce the percentage of a state tax shared with counties or municipalities.

V. COMMENTS:

A. CONSTITUTIONAL ISSUES:

None

B. RULE-MAKING AUTHORITY:

The provisions of this bill appear to be inconsistent with the current rule-making authority provided the Prepaid Board. Section 240.551(8), F.S., authorizes the Prepaid Board to adopt rules “. . . necessary to enable the program to retain its status as a ‘qualified State tuition program’ in order to maintain its tax exempt status or other similar status of the program, purchasers, and qualified beneficiaries.”

C. OTHER COMMENTS:

None.

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VI. AMENDMENTS OR COMMITTEE SUBSTITUTE CHANGES:

None.

VII. SIGNATURES:

COMMITTEE ON COMMITTEE ON COLLEGES & UNIVERSITIES:

Prepared by:

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Betty H. Tilton, Ph.D.

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