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INTRODUCED BY

House BILL NO. *536*
JOHN BOHLINGER

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A BILL FOR AN ACT ENTITLED: "AN ACT ESTABLISHING THE FAMILY EDUCATION SAVINGS ACT; ESTABLISHING A FAMILY EDUCATION SAVINGS PROGRAM OVERSIGHT COMMITTEE; ESTABLISHING PROCEDURES AUTHORIZING A PERSON TO MAKE CONTRIBUTIONS TO ACCOUNTS THAT ARE ESTABLISHED TO PAY HIGHER EDUCATION EXPENSES FOR A DESIGNATED BENEFICIARY OF AN ACCOUNT OWNER; REQUIRING THE BOARD OF REGENTS TO IMPLEMENT THE PROGRAM AND AUTHORIZING THE BOARD TO SELECT FINANCIAL INSTITUTIONS TO ACT AS DEPOSITORIES AND PROGRAM MANAGERS, USING SPECIFIED BIDDING CRITERIA; PROVIDING FOR THE FEDERAL DEFERRAL OF TAXES ON INVESTMENT EARNINGS CONTRIBUTED TO AN ACCOUNT; PROVIDING A DEDUCTION FROM STATE INCOME TAX PURPOSES OF UP TO \$3,000 ANNUALLY FOR CONTRIBUTIONS TO AN ACCOUNT; REQUIRING ANNUAL REPORTING OF CONTRIBUTIONS RECEIVED TO THE INTERNAL REVENUE SERVICE AND THE ACCOUNT OWNER; REQUIRING DISTRIBUTIONS FROM AN ACCOUNT TO BE REPORTED TO THE INTERNAL REVENUE SERVICE AND THE ACCOUNT OWNER; PROVIDING A 10 PERCENT PENALTY FOR A NONQUALIFIED WITHDRAWAL FROM AN ACCOUNT; AUTHORIZING A CHANGE IN DESIGNATED BENEFICIARY BY AN ACCOUNT OWNER UNDER CERTAIN CONDITIONS; AUTHORIZING THE WITHDRAWAL OF ALL OR PART OF THE BALANCE OF AN ACCOUNT PURSUANT TO BOARD OF REGENT RULES; PROHIBITING USE OF ACCOUNT INTEREST AS LOAN SECURITY; AMENDING SECTION 15-30-111, MCA; AND PROVIDING AN EFFECTIVE DATE."

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BE IT ENACTED BY THE LEGISLATURE OF THE STATE OF MONTANA:

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NEW SECTION. **Section 1. Short title.** [Sections 1 through 5 and 8 through 11] may be cited as the "Family Education Savings Act".

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NEW SECTION. **Section 2. Purpose.** (1) It is the intent of the legislature to establish the Family Education Savings Act in recognition that the general welfare and well-being of the state of Montana are directly related to the educational levels and skills of its citizens. A vital and valid public purpose of the state of Montana is served by the establishment and implementation of a program that will encourage and

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1 make possible the attainment of an accessible, affordable postsecondary education by the greatest number
2 of citizens through a savings program.

3 (2) The legislature further intends that the board achieve this purpose most effectively through a
4 public-private partnership using selected financial institutions to serve as depositories for individuals'
5 postsecondary education savings accounts.

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7 **NEW SECTION. Section 3. Definitions.** As used in [sections 1 through 5 and 8 through 11], the
8 following definitions apply:

9 (1) "Account" means an individual trust account or savings account established under [sections 1
10 through 5 and 8 through 11].

11 (2) "Account owner" means the person designated at the time that an account is opened as having
12 the right to withdraw money from the account before the account is disbursed to or for the benefit of the
13 designated beneficiary.

14 (3) "Board" means the board of regents of higher education established by Article X, section 9,
15 subsection (2), of the Montana constitution and 2-15-1505.

16 (4) "Committee" means the family education savings program oversight committee established in
17 [section 6].

18 (5) "Designated beneficiary" means, with respect to an account, the person designated at the time
19 that the account is opened as the person whose higher education expenses are expected to be paid from
20 the account or if this person is replaced in accordance with [section 5], the individual replacing the former
21 designated beneficiary.

22 (6) "Financial institution" means any bank, commercial bank, national bank, savings bank, savings
23 and loan association, credit union, insurance company, trust company, mutual fund, or other similar entity
24 that is authorized to do business in this state.

25 (7) "Higher education institution" means:

26 (a) an institution described in the Higher Education Act of 1965, 20 U.S.C. 1141(a) and 1088(a);

27 or

28 (b) an area vocational educational school, as defined in section 521(3) of the Carl D. Perkins
29 Vocational Education Act, 20 U.S.C. 2471(3)(C) and (3)(D), that is located in this state.

30 (8) "Member of the family" means:

- 1 (a) an ancestor of a person;
- 2 (b) the spouse of a person;
- 3 (c) a lineal descendant, including a legally adopted child, of a person, of a person's spouse, or of
- 4 a parent of a person; or
- 5 (d) the spouse of any lineal descendant described in subsection (8)(c).

6 (9) "Nonqualified withdrawal" means a withdrawal from an account that is not:

- 7 (a) a qualified withdrawal;
- 8 (b) a withdrawal made as the result of the death or disability of the designated beneficiary of an
- 9 account;
- 10 (c) a withdrawal that is made on the account of a scholarship or the allowance or payment
- 11 described in section 135(d)(1)(B) or (d)(1)(C) of the Internal Revenue Code, 26 U.S.C. 135(d)(1)(B) or
- 12 (d)(1)(C), and that is received by the designated beneficiary; or
- 13 (d) a rollover or change of designated beneficiary.

14 (10) "Program" means the family education savings program established pursuant to [section 4].
15 The program must be structured to permit the long-term accumulation of savings that can be used to
16 finance all or a share of the costs of higher education.

17 (11) "Qualified higher education expenses" means tuition and fees required for enrollment or
18 attendance of a designated beneficiary at a higher education institution.

19 (12) "Qualified withdrawal" means a withdrawal from an account to pay the qualified higher
20 education expenses of the designated beneficiary of the account.

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22 **NEW SECTION. Section 4. Program requirements -- application -- establishment of account --**
23 **qualified and nonqualified withdrawal -- penalties.** (1) A person who wishes to deposit money into an
24 account to pay the qualified higher education expenses of a designated beneficiary shall:

- 25 (a) complete an application on the form prescribed by the board that includes:
- 26 (i) the name, address, and social security number or employer identification number of the
- 27 contributor;
- 28 (ii) the name, address, and social security number of the account owner if the account owner is
- 29 not the contributor;
- 30 (iii) the name, address, and social security number of the designated beneficiary;

1 (iv) the certification relating to no excess contributions adopted by the board pursuant to [section
2 7]; and

3 (v) any other information required by the board;

4 (b) pay the one-time application fee established by the board;

5 (c) make the minimum contribution required by the board or by opening an account; and

6 (d) designate the type of account to be opened if more than one type of account is offered.

7 (2) A person shall make contributions to an opened account in cash.

8 (3) An account owner may withdraw all or part of the balance from an account under rules
9 prescribed by the board to enable the board or program manager to determine if a withdrawal is a
10 nonqualified withdrawal or a qualified withdrawal. The rules may require that:

11 (a) account owners seeking to make a qualified withdrawal or other withdrawal that is not a
12 nonqualified withdrawal shall provide certifications, copies of bills for qualified higher education expenses,
13 or other supporting material;

14 (b) qualified withdrawals from an account be made only by a check payable jointly to the
15 designated beneficiary and a higher education institution; and

16 (c) withdrawals not meeting certain requirements be treated as nonqualified withdrawals by the
17 program manager, and if these withdrawals are not nonqualified withdrawals, the account owner shall seek
18 refunds of penalties directly from the board.

19 (4) If a nonqualified withdrawal is made from an account, an amount equal to 10% of the portion
20 of the proposed withdrawal that would constitute income as determined in accordance with section 529
21 of the Internal Revenue Code, 26 U.S.C. 529, must be withheld as a penalty and paid to the board for use
22 in operating and marketing the program and for state student financial aid.

23 (5) The board, by rule, shall increase the percentage of the penalty prescribed in subsection (4) or
24 change the basis of this penalty if the board determines that the amount of the penalty must be increased
25 to constitute a minimum penalty for purposes of qualifying the program as a qualified state tuition program
26 under section 529 of the Internal Revenue Code, 26 U.S.C. 529.

27 (6) The board may decrease the percentage of the penalty prescribed in subsection (4) if:

28 (a) the penalty is greater than is required to constitute a minimum penalty for purposes of qualifying
29 the program as a qualified state tuition program under section 529 of the Internal Revenue Code, 26 U.S.C.
30 529; or

1 (b) the penalty, when combined with other revenue generated under [sections 1 through 5 and 8
2 through 11], is producing more revenue than is required to cover the costs of operating and marketing the
3 program and to recover any costs not previously recovered.

4 (7) If an account owner makes a nonqualified withdrawal and a penalty amount is not withheld
5 pursuant to subsection (4) or the amount withheld was less than the amount required to be withheld under
6 that subsection for nonqualified withdrawals, the account owner shall pay:

7 (a) the unpaid portion of the penalty to the board at the same time that the account owner files
8 a federal and state income tax return for the taxable year of the withdrawal; or

9 (b) if the account owner does not file a return, the unpaid portion of the penalty on the due date
10 for federal and state income tax returns, including any authorized extensions.

11 (8) Each account must be maintained separately from each other account under the program.

12 (9) Separate records and accounting must be maintained for each account for each designated
13 beneficiary.

14 (10) A contributor to, account owner of, or designated beneficiary of an account may not direct
15 the investment of any contributions to any account or the earnings generated by the account and may not
16 pledge the interest of an account or use an interest in an account as security for a loan.

17 (11) If the board terminates the authority of a financial institution to hold accounts and accounts
18 must be moved from that financial institution to another financial institution, the board shall select the
19 financial institution and type of investment to which the balance of the account is moved unless the internal
20 revenue service provides guidance stating that allowing the account owner to select among several financial
21 institutions that are then contractors would not cause a plan to cease to be a qualified state tuition plan.

22 (12) If there is any distribution from an account to any person or for the benefit of any person
23 during a calendar year, the distribution must be reported to the internal revenue service and the account
24 owner or the designated beneficiary to the extent required by federal law.

25 (13) The financial institution shall provide statements to each account owner at least once each
26 year within 31 days after the 12-month period to which they relate. The statement must identify the
27 contributions made during a preceding 12-month period, the total contributions made through the end of
28 the period, the value of the account as of the end of this period, distributions made during this period, and
29 any other matters that the board requires be reported to the account owner.

30 (14) Statements and information returns relating to accounts must be prepared and filed to the

1 extent required by federal or state tax law.

2 (15) A state or local government or organizations described in section 501(c)(3) of the Internal
3 Revenue Code, 26 U.S.C. 501(c)(3), may, without designating a designated beneficiary, open and become
4 the account owner of an account to fund scholarships for persons whose identity will be determined after
5 an account is opened.

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7 **NEW SECTION. Section 5. Changes in designated beneficiary.** (1) An account owner may change
8 the designated beneficiary of an account to an individual who is a member of the family of the former
9 designated beneficiary in accordance with procedures established by the board.

10 (2) If requested by an account owner, all or a portion of an account may be transferred to another
11 account of which the designated beneficiary is a member of the family of the designated beneficiary of the
12 transferee account.

13 (3) Changes in designated beneficiaries and rollovers under this section are not permitted if the
14 changes or rollovers would violate:

- 15 (a) the excess contributions provisions adopted by the board pursuant to [section 7]; or
- 16 (b) the investment choice provisions of [section 4(10)].

17
18 **NEW SECTION. Section 6. Family education savings program oversight committee -- membership**
19 **-- powers and duties.** (1) There is created a family education savings program oversight committee under
20 the authority of the board.

21 (2) The committee consists of seven members appointed by the governor to staggered 4-year
22 terms. The members must include:

- 23 (a) the commissioner of insurance or the commissioner’s designee;
- 24 (b) the director of the department of commerce or the director’s designee;
- 25 (c) the state treasurer or the state treasurer’s designee;
- 26 (d) the presiding officer of the board or the presiding officer’s designee; and
- 27 (e) three members of the general public, each of whom possesses knowledge, skill, and experience
28 in accounting, risk management, or investment management or as an actuary.

29 (3) The committee shall select a presiding officer and a vice presiding officer from among the
30 committee’s membership.

1 (4) A majority of the membership constitutes a quorum for the transaction of business. The
2 committee shall meet at least once a year, with additional meetings called by the presiding officer.

3 (5) The committee:

4 (a) shall recommend financial institutions for approval by the board to act as the depositories and
5 managers of family education savings accounts pursuant to [section 4]; and

6 (b) may submit proposed policies to the board to assist in the implementation and administration
7 of [sections 1 through 5 and 8 through 11].

8 (6) The committee is allocated to the board for administrative purposes only, as prescribed in
9 2-15-121.

10 (7) Members of the committee must be compensated as provided in 2-15-124.

11 (8) The definitions in [section 3] apply to this section.

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13 **NEW SECTION. Section 7. Board -- powers and duties.** (1) The board shall:

14 (a) retain professional services, if necessary, including services of accountants, auditors,
15 consultants, and other experts;

16 (b) seek rulings and other guidance relating to the program from the United States department of
17 the treasury and the internal revenue service;

18 (c) make changes to the program as required for the participants in the program to obtain the
19 federal income tax benefits or treatment provided by section 529 of the Internal Revenue Code, 26 U.S.C.
20 529, as amended;

21 (d) charge, impose, and collect administrative fees and service charges pursuant to any agreement,
22 contract, or transaction relating to the program;

23 (e) select the financial institution or institutions to act as the depository and manager of the program
24 pursuant to [section 8];

25 (f) on the recommendation of the committee, adopt rules to prevent contributions on behalf of a
26 designated beneficiary in excess of those necessary to pay the qualified higher education expenses of the
27 designated beneficiaries. The rules must address the following:

28 (i) procedures for aggregating the total balances of multiple accounts established for a designated
29 beneficiary;

30 (ii) the establishment of a maximum total balance that may be held in accounts for a designated

1 beneficiary;

2 (iii) requirements that persons who contribute to an account certify that to the best of their
3 knowledge, the balance in all qualified state tuition programs, as defined in section 529 of the Internal
4 Revenue Code, 26 U.S.C. 529, for the designated beneficiary does not exceed the lesser of:

5 (A) a maximum college savings amount established by the board; or

6 (B) the cost in current dollars of qualified higher education expenses that the contributor reasonably
7 anticipates the designated beneficiary will incur;

8 (iv) requirements that any excess balances with respect to a designated beneficiary be promptly
9 withdrawn in a nonqualified withdrawal or rolled over to another account in accordance with this section;

10 and

11 (g) adopt procedures as necessary to implement [sections 1 through 5 and 8 through 11].

12 (2) The definitions in [section 3] apply to this section.

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14 **NEW SECTION. Section 8. Selection of financial institution as account depository and manager**

15 -- **contract -- termination.** (1) The board shall implement the program through the use of one or more
16 financial institutions to act as the depository and manager. Under the program, a person may establish
17 accounts at the depository.

18 (2) The committee shall solicit proposals from financial institutions to act as the depositories and
19 managers of the program. Financial institutions that submit proposals shall describe the financial
20 instruments that will be held in accounts.

21 (3) On the recommendation of the committee, the board shall select as program depositories and
22 managers the financial institution or institutions from among bidding financial institutions that demonstrate
23 the most advantageous combination, both to potential program participants and to this state, of:

24 (a) financial stability and integrity;

25 (b) the safety of the investment instruments being offered, taking into account any insurance
26 provided with respect to these instruments;

27 (c) the ability of the investment instruments to track estimated costs of higher education as
28 calculated by the board and provided by the financial institution to the account holder;

29 (d) the ability of the financial institutions, directly or through a subcontract, to satisfy
30 recordkeeping and reporting requirements;

1 (e) the financial institution's plan for promoting the program and the investment that it is willing
2 to make to promote the program;

3 (f) the fees, if any, proposed to be charged to persons for maintaining accounts;

4 (g) the minimum initial deposit and minimum contributions that the financial institution will require
5 and the willingness of the financial institution or its subcontractors to accept contributions through payroll
6 deduction plans and other deposit plans; and

7 (h) any other benefits to this state or its residents contained in the proposal, including an account
8 opening fee payable to the board by the account owner to cover expenses of operation of the program and
9 any additional fee offered by the financial institution for statewide program marketing by the board.

10 (4) The board shall enter into a contract with a financial institution or, except as provided in
11 subsection (5), into contracts with financial institutions to serve as depositories and program managers.

12 (5) The committee may select more than one financial institution and investment for the program
13 if:

14 (a) the internal revenue service has provided guidance that giving a contributor a choice of two or
15 more investment instruments under a state plan will not cause the plan to fail to qualify for favorable tax
16 treatment under section 529 of the Internal Revenue Code, 26 U.S.C. 529; and

17 (b) the committee concludes that the choice of instrument vehicles is in the best interest of
18 program participants and will not interfere with the promotion of the program.

19 (6) A program manager or its subcontractor shall:

20 (a) take action required to keep the program in compliance with its contract or the requirements
21 of [sections 1 through 5 and 8 through 11] to manage the program so that it is treated as a qualified state
22 tuition plan under section 529 of the Internal Revenue Code, 26 U.S.C. 529;

23 (b) keep adequate records of each account, keep each account segregated from each other
24 account, and provide the board with the information necessary to prepare statements required by [section
25 4(12) through (14)] or file these statements on behalf of the board;

26 (c) compile and total information contained in statements required to be prepared under [section
27 4(12) through (14)] and provide these compilations to the board;

28 (d) if there is more than one program manager, provide the board with the information to assist the
29 board in determining compliance with rules adopted by the board pursuant to [section 7];

30 (e) provide representatives of the board, including other contractors or other state agencies, access

1 to the books and records of the program manager to the extent needed to determine compliance with the
 2 contract. At least once during the term of any contract, the board, its contractor, or the state agency
 3 responsible for examination oversight of the program manager shall conduct an examination to the extent
 4 needed to determine compliance with the contract.

5 (f) hold all accounts in trust for the benefit of this state and the account owner.

6 (7) A person may not circulate any description of the program, whether in writing or through the
 7 use of any media, unless the board or its designee first approves the description.

8 (8) A contract executed between the board and a financial institution pursuant to this section must
 9 be for a term of at least 3 years and not more than 7 years.

10 (9) If a contract executed between the board and a financial institution pursuant to this section is
 11 not renewed, at the end of the term of the nonrenewed contract:

12 (a) accounts previously established and held in investment instruments at the financial institution
 13 may not be terminated;

14 (b) additional contributions may be made to the accounts in existence at the time of nonrenewal
 15 of a contract; and

16 (c) new accounts may not be placed with that financial institution unless a new contract is
 17 executed.

18 (10) The board may terminate a contract with a financial institution at any time for good cause on
 19 the recommendation of the committee. If a contract is terminated pursuant to this subsection, the board
 20 shall take custody of accounts held at that financial institution and shall seek to promptly transfer the
 21 accounts to another financial institution that is selected as a program manager and into investment
 22 instruments as similar as possible to the original investments.

23

24 **NEW SECTION. Section 9. Higher education expenses -- exemption from taxable income.** A
 25 person may in any year deposit into an individual trust or savings account up to \$3,000 that is deductible
 26 for tax purposes under 15-30-111(2)(k) to pay the qualified higher education expenses for the benefit of
 27 a designated beneficiary.

28

29 **NEW SECTION. Section 10. Scholarships and financial aid provisions -- exceptions.** (1) Except
 30 as provided in subsection (2), a student loan program, student grant program, or other financial assistance

1 program established or administered by the state or a financial assistance program administered by a
 2 state-supported college or university must treat the balance in an account of which the student is a
 3 designated beneficiary as if it were an asset of the parent of the designated beneficiary and not as a
 4 scholarship or grant or as an asset of the student for determining a student's or parent's income, assets,
 5 or financial need.

6 (2) This section does not apply if:

7 (a) federal law requires all or a portion of the amount in an account to be taken into account in a
 8 different manner;

9 (b) federal benefits could be lost if all or a portion of the amount in an account is not taken into
 10 account in a different manner; or

11 (c) a specific grant establishing a financial assistance program requires that all or a portion of the
 12 amount in an account be taken into account.

13

14 NEW SECTION. **Section 11. Limitations.** (1) [Sections 1 through 5 and 8 through 11] may not
 15 be construed to:

16 (a) give any designated beneficiary any rights or legal interest with respect to an account unless
 17 the designated beneficiary is the account owner;

18 (b) guarantee that a designated beneficiary will be admitted to a higher education institution or be
 19 allowed to continue enrollment at or graduate from a higher education institution located in this state after
 20 admission;

21 (c) establish state residency for a person merely because the person is a designated beneficiary;
 22 or

23 (d) guarantee that amounts saved pursuant to the program will be sufficient to cover the qualified
 24 higher education expenses of a designated beneficiary.

25 (2) [Sections 1 through 5 and 8 through 11] do not establish any obligation of this state or any
 26 agency or instrumentality of the state to guarantee for the benefit of any account owner, contributor to an
 27 account, or designated beneficiary:

28 (a) the return of any amounts contributed to an account;

29 (b) the rate of interest or other return on any account; or

30 (c) the payment of interest or other return on any account.

1 (3) Under rules adopted by the board, each contract, application, deposit slip, or other document
2 that may be used in connection with a contribution to an account must clearly indicate that the account
3 is not insured by the state and that the principal deposited or the investment return is not guaranteed by
4 the state.

5

6 **Section 12.** Section 15-30-111, MCA, is amended to read:

7 **"15-30-111. Adjusted gross income.** (1) Adjusted gross income is the taxpayer's federal income
8 tax adjusted gross income as defined in section 62 of the Internal Revenue Code of 1954, 26 U.S.C. 62,
9 as that section may be labeled or amended, and in addition includes the following:

10 (a) (i) interest received on obligations of another state or territory or county, municipality, district,
11 or other political subdivision of another state, except to the extent that the interest is exempt from taxation
12 by Montana under federal law;

13 (ii) exempt-interest dividends as defined in section 852(b)(5) of the Internal Revenue Code of 1986,
14 26 U.S.C. 852(b)(5), as that section may be amended or renumbered, that are attributable to the interest
15 referred to in subsection (1)(a)(i);

16 (b) refunds received of federal income tax, to the extent that the deduction of the tax resulted in
17 a reduction of Montana income tax liability;

18 (c) that portion of a shareholder's income under subchapter S. of Chapter 1 of the Internal Revenue
19 Code of 1954 that has been reduced by any federal taxes paid by the subchapter S. corporation on the
20 income;

21 (d) depreciation or amortization taken on a title plant as defined in 33-25-105(15); and

22 (e) the recovery during the tax year of an amount deducted in any prior tax year to the extent that
23 the amount recovered reduced the taxpayer's Montana income tax in the year deducted.

24 (2) Notwithstanding the provisions of the federal Internal Revenue Code of 1954, as labeled or
25 amended, adjusted gross income does not include the following, which are exempt from taxation under this
26 chapter:

27 (a) (i) all interest income from obligations of the United States government, the state of Montana,
28 county, municipality, district, or other political subdivision of the state and any other interest income that
29 is exempt from taxation by Montana under federal law;

30 (ii) exempt-interest dividends as defined in section 852(b)(5) of the Internal Revenue Code of 1986,

- 1 26 U.S.C. 852(b)(5), as that section may be amended or renumbered, that are attributable to the interest
2 referred to in subsection (2)(a)(i);
- 3 (b) interest income earned by a taxpayer who is 65 years of age or older in a tax year up to and
4 including \$800 for a taxpayer filing a separate return and \$1,600 for each joint return;
- 5 (c) (i) except as provided in subsection (2)(c)(ii), the first \$3,600 of all pension and annuity income
6 received as defined in 15-30-101;
- 7 (ii) for pension and annuity income described under subsection (2)(c)(i), as follows:
- 8 (A) each taxpayer filing singly, head of household, or married filing separately shall reduce the total
9 amount of the exclusion provided in subsection (2)(c)(i) by \$2 for every \$1 of federal adjusted gross income
10 in excess of \$30,000 as shown on the taxpayer's return;
- 11 (B) in the case of married taxpayers filing jointly, if both taxpayers are receiving pension or annuity
12 income or if only one taxpayer is receiving pension or annuity income, the exclusion claimed as provided
13 in subsection (2)(c)(i) must be reduced by \$2 for every \$1 of federal adjusted gross income in excess of
14 \$30,000 as shown on their joint return;
- 15 (d) all Montana income tax refunds or tax refund credits;
- 16 (e) gain required to be recognized by a liquidating corporation under 15-31-113(1)(a)(ii);
- 17 (f) all tips or gratuities that are covered by section 3402(k) or service charges that are covered by
18 section 3401 of the Internal Revenue Code of 1954, 26 U.S.C. 3402(k) or 3401, as amended and
19 applicable on January 1, 1983, received by persons for services rendered by them to patrons of premises
20 licensed to provide food, beverage, or lodging;
- 21 (g) all benefits received under the workers' compensation laws;
- 22 (h) all health insurance premiums paid by an employer for an employee if attributed as income to
23 the employee under federal law;
- 24 (i) all money received because of a settlement agreement or judgment in a lawsuit brought against
25 a manufacturer or distributor of "agent orange" for damages resulting from exposure to "agent orange";
- 26 (j) principal and income in a medical care savings account established in accordance with
27 15-61-201 or withdrawn from an account for eligible medical expenses, as defined in 15-61-102, of the
28 taxpayer or a dependent of the taxpayer or for the long-term care of the taxpayer or a dependent of the
29 taxpayer; ~~and~~
- 30 (k) principal and income in a family education savings program account established in accordance

1 with [section 4] or withdrawn from an account for qualified higher education expenses, as defined in
2 [section 3], for a designated beneficiary of the taxpayer; and

3 ~~(k)(l)~~ the recovery during the tax year of any amount deducted in any prior tax year to the extent
4 that the recovered amount did not reduce the taxpayer's Montana income tax in the year deducted.

5 (3) A shareholder of a DISC that is exempt from the corporation license tax under 15-31-102(1)(l)
6 shall include in the shareholder's adjusted gross income the earnings and profits of the DISC in the same
7 manner as provided by section 995 of the Internal Revenue Code, 26 U.S.C. 995, for all periods for which
8 the DISC election is effective.

9 (4) A taxpayer who, in determining federal adjusted gross income, has reduced the taxpayer's
10 business deductions by an amount for wages and salaries for which a federal tax credit was elected under
11 ~~section 44B~~ sections 38 and 51(a) of the Internal Revenue Code of 1954, as ~~that section~~ those sections
12 may be labeled or amended, is allowed to deduct the amount of the wages and salaries paid regardless of
13 the credit taken. The deduction must be made in the year the wages and salaries were used to compute
14 the credit. In the case of a partnership or small business corporation, the deduction must be made to
15 determine the amount of income or loss of the partnership or small business corporation.

16 (5) Married taxpayers filing a joint federal return who are required to include part of their social
17 security benefits or part of their tier 1 railroad retirement benefits in federal adjusted gross income may split
18 the federal base used in calculation of federal taxable social security benefits or federal taxable tier 1
19 railroad retirement benefits when they file separate Montana income tax returns. The federal base must be
20 split equally on the Montana return.

21 (6) A taxpayer receiving retirement disability benefits who has not attained age 65 by the end of
22 the tax year and who has retired as permanently and totally disabled may exclude from adjusted gross
23 income up to \$100 per week received as wages or payments in lieu of wages for a period during which the
24 employee is absent from work due to the disability. If the adjusted gross income before this exclusion and
25 before application of the two-earner married couple deduction exceeds \$15,000, the excess reduces the
26 exclusion by an equal amount. This limitation affects the amount of exclusion, but not the taxpayer's
27 eligibility for the exclusion. If eligible, married individuals shall apply the exclusion separately, but the
28 limitation for income exceeding \$15,000 is determined with respect to the spouses on their combined
29 adjusted gross income. For the purpose of this subsection, permanently and totally disabled means unable
30 to engage in any substantial gainful activity by reason of any medically determined physical or mental

1 impairment lasting or expected to last at least 12 months. (Subsection (2)(f) terminates on occurrence of
2 contingency--sec. 3, Ch. 634, L. 1983.)"

3

4 NEW SECTION. **Section 13. Implementation of staggered terms.** (1) To implement the
5 staggered-term system provided for in [section 6], the first terms of the members are as follows:

6 (a) one member shall serve a 1-year term;

7 (b) two members shall serve 2-year terms;

8 (c) two members shall serve 3-year terms; and

9 (d) two members shall serve 4-year terms.

10 (2) Upon expiration of the terms provided for in subsection (1), each member shall serve a 4-year
11 term.

12

13 NEW SECTION. **Section 14. Codification instruction.** (1) [Sections 1 through 5 and 8 through 11]
14 are intended to be codified as an integral part of Title 15, and the provisions of Title 15 apply to [sections
15 1 through 5 and 8 through 11].

16 (2) [Sections 6 and 7] are intended to be codified as an integral part of Title 20, chapter 25, and
17 the provisions of Title 20, chapter 25, apply to [sections 6 and 7].

18

19 NEW SECTION. **Section 15. Effective date.** [This act] is effective July 1, 1997.

20

-END-

STATE OF MONTANA - FISCAL NOTE

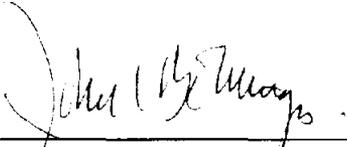
Fiscal Note for HB0536, IntroducedDESCRIPTION OF PROPOSED LEGISLATION:

An act establishing the family education savings act; establishing a family education savings program oversight committee; establishing procedures authorizing a person to make contributions to accounts that are established to pay higher education expenses for a designated beneficiary of an account owner; requiring the board of regents to implement the program and authorizing the board to select financial institutions to act as depositories and program managers, using specified bidding criteria; providing for the federal deferral of taxes on investment earnings contributed to an account; providing a deduction from state income tax purposes of up to \$3,000 annually for contributions to an account; requiring annual reporting of contributions received to the Internal Revenue Service and the account owner; requiring distributions from an account to be reported to the Internal Revenue Service and the account owner; providing a 10 percent penalty for a nonqualified withdrawal from an account; authorizing a change in designated beneficiary by an account owner under certain conditions; authorizing the withdrawal of all or part of the balance of an account pursuant to Board of Regent rules; prohibiting use of account interest as loan security; and providing an effective date.

ASSUMPTIONS:

1. The effective date of this proposal is July 1, 1997.
2. Interest earnings and contributions (up to \$3,000 annually) are exempt from state income tax. Interest earnings are federally tax deferred until used by the beneficiary, at which time they are taxed at the beneficiary's tax rate.
3. The Kentucky Educational Savings Plan Trust (operated since 1990) is the only long-running program that is similar to this college savings proposal.
4. Approximately 500 new accounts were established in Kentucky each year before the federal tax deferral of interest was available.
5. The average annual contribution to Kentucky accounts is \$540, or \$45 per month.
6. Kentucky exempts only interest earnings, not contributions, from state income tax.
7. State deductibility of interest and contributions (up to \$3,000 annually), as well as the federal tax deferral on interest, should make the program participation rate in Montana greater than that in Kentucky. Montana has higher marginal income tax rates than Kentucky (Kentucky's highest marginal tax rate is 6%—Montana's is 11%), which would increase participation as well.
8. The ratio of Montana's population under age 18 to Kentucky's population under age 18 is approximately 0.24. Based on this ratio, we could expect 122 new accounts to be opened in Montana each year. However, given all of the factors in assumption 7, it is estimated that closer to 200 new accounts would be established each year.
9. Approximately 150 accounts would be established in the first year of Montana's program.
10. Income per capita and median household income in Kentucky is very similar to that of Montana. Because of this, the average annual contribution to accounts should be approximately the same \$540.
11. Any loss to the state from untaxed interest earnings would be minimal for the first few years of the program.
12. The total amount of contributions deducted from state income tax equals \$81,000 (150 × \$540) for FY 98 and \$189,000 ((150 + 200) × \$540) for FY 99. Assuming an average marginal tax rate of 6% for contributors, the loss of revenue to the state from deductions would be \$4,860 in FY 98 and \$11,340 for FY 99.
13. Department of Revenue administrative expenses include initial programming and development costs and ongoing storage costs of \$14,545 in FY 98 and \$254 in FY 99.
14. It is assumed that the Family Education Savings Program Committee would meet six times in the first year and two times for each year thereafter. Per diem and travel costs would need to be paid for three members of the general public, and a member of the Board of Regents.

 2-18-97
 DAVE LEWIS, BUDGET DIRECTOR DATE
 Office of Budget and Program Planning


 JOHN BOHLINGER, PRIMARY SPONSOR DATE
 Fiscal Note for HB 0536, as Introduced

HB536

(continued)

15. The Office of the Commissioner of Higher Education has \$20,000 budgeted for the biennium for "outside" contracted professional services related to implementation, operational support and program oversight.
16. The commissioner of insurance or the commissioner's designee will be a member of the program oversight committee. The committee will meet at least once a year, with possibly additional meetings called by the presiding officer.
17. There may be additional travel expense to the State Auditor's Office, Department of Commerce and Department of Administration for these meetings. Location of and frequency of the meetings will dictate the additional expenses, but these expenses should be absorbed within existing budgets.
18. Fees collected for this program cover the costs of the program in the Office of the Commissioner of Higher Education. An applicant fee of \$10 will generate 150 X \$10 = \$1,500 in FY98 and 200 X \$10 = \$2,000 in FY99. The fee from the account depository and program manager would be \$30,000 for a three year contract.

<u>FISCAL IMPACT:</u>	FY 98 <u>Difference</u>	FY 99 <u>Difference</u>
<u>Expenditures: Office of the Commissioner of Higher Education</u>		
Per Diem	1,200	400
Travel	3,353	1,114
Contracted Services	<u>20,000</u>	<u>0</u>
Total	24,553	1,514
 <u>Funding:</u>		
Fees (02)	24,553	1,514
 <u>Expenditures: Department of Revenue</u>		
Programming	7,318	
Development	7,100	
Storage Costs	<u>127</u>	<u>254</u>
Total	14,545	254
 <u>Funding:</u>		
General Fund (01)	14,545	254
 <u>Revenues:</u>		
Income Tax (01)	(4,860)	(11,340)
Fees (02)	31,500	2,000
 <u>Net Impact (revenue minus expenditure):</u>		
General Fund(01)	(19,405)	(11,594)
Fee account (02)	6,947	486

LONG-RANGE EFFECTS OF PROPOSED LEGISLATION:

Total deductions will increase over time as more taxpayers establish savings accounts.

TECHNICAL NOTES:

1. Withdrawals for nonqualified expenses are not taxed by Montana in this bill.
2. It can be interpreted that there is a double deduction of interest earnings. Montana adjusted gross income is based on federal adjusted gross income, which already excludes interest earnings on college savings accounts, excluding interest from Montana adjusted gross income would result in a double deduction of interest.
3. Although the bill allows for charging and collecting an administrative fee related to this act, it does not address if the Board of Regents should recover all costs associated with the administration of the program.
4. The bill does not contain an appropriation for any fees that might be assessed.

1 HOUSE BILL NO. 536

2 INTRODUCED BY BOHLINGER

3
4 A BILL FOR AN ACT ENTITLED: "AN ACT ESTABLISHING THE FAMILY EDUCATION SAVINGS ACT;
5 ESTABLISHING A FAMILY EDUCATION SAVINGS PROGRAM OVERSIGHT COMMITTEE; ESTABLISHING
6 PROCEDURES AUTHORIZING A PERSON TO MAKE CONTRIBUTIONS TO ACCOUNTS THAT ARE
7 ESTABLISHED TO PAY HIGHER EDUCATION EXPENSES FOR A DESIGNATED BENEFICIARY OF AN
8 ACCOUNT OWNER; REQUIRING THE BOARD OF REGENTS TO IMPLEMENT THE PROGRAM AND
9 AUTHORIZING THE BOARD TO SELECT FINANCIAL INSTITUTIONS TO ACT AS DEPOSITORIES AND
10 PROGRAM MANAGERS, USING SPECIFIED BIDDING CRITERIA; PROVIDING FOR THE FEDERAL DEFERRAL
11 OF TAXES ON INVESTMENT EARNINGS CONTRIBUTED TO AN ACCOUNT; PROVIDING A DEDUCTION
12 FROM STATE INCOME TAX PURPOSES OF UP TO \$3,000 ANNUALLY FOR CONTRIBUTIONS TO AN
13 ACCOUNT; REQUIRING ANNUAL REPORTING OF CONTRIBUTIONS RECEIVED TO THE INTERNAL
14 REVENUE SERVICE AND THE ACCOUNT OWNER; REQUIRING DISTRIBUTIONS FROM AN ACCOUNT TO
15 BE REPORTED TO THE INTERNAL REVENUE SERVICE AND THE ACCOUNT OWNER; PROVIDING A 10
16 PERCENT PENALTY FOR A NONQUALIFIED WITHDRAWAL FROM AN ACCOUNT; AUTHORIZING A
17 CHANGE IN DESIGNATED BENEFICIARY BY AN ACCOUNT OWNER UNDER CERTAIN CONDITIONS;
18 AUTHORIZING THE WITHDRAWAL OF ALL OR PART OF THE BALANCE OF AN ACCOUNT PURSUANT TO
19 BOARD OF REGENT RULES; PROHIBITING USE OF ACCOUNT INTEREST AS LOAN SECURITY; AMENDING
20 SECTION 15-30-111, MCA; AND PROVIDING AN EFFECTIVE DATE."

21
22 BE IT ENACTED BY THE LEGISLATURE OF THE STATE OF MONTANA:

23
24 NEW SECTION. **Section 1. Short title.** [Sections 1 through 5 and 8 through 11] may be cited as
25 the "Family Education Savings Act".

26
27 NEW SECTION. **Section 2. Purpose.** (1) It is the intent of the legislature to establish the Family
28 Education Savings Act in recognition that the general welfare and well-being of the state of Montana are
29 directly related to the educational levels and skills of its citizens. A vital and valid public purpose of the
30 state of Montana is served by the establishment and implementation of a program that will encourage and

1 make possible the attainment of an accessible, affordable postsecondary education by the greatest number
2 of citizens through a savings program.

3 (2) The legislature further intends that the board achieve this purpose most effectively through a
4 public-private partnership using selected financial institutions to serve as depositories for individuals'
5 postsecondary education savings accounts.

6

7 **NEW SECTION. Section 3. Definitions.** As used in [sections 1 through 5 and 8 through 11], the
8 following definitions apply:

9 (1) "Account" means an individual trust account or savings account established under [sections 1
10 through 5 and 8 through 11].

11 (2) "Account owner" means the person designated at the time that an account is opened as having
12 the right to withdraw money from the account before the account is disbursed to or for the benefit of the
13 designated beneficiary.

14 (3) "Board" means the board of regents of higher education established by Article X, section 9,
15 subsection (2), of the Montana constitution and 2-15-1505.

16 (4) "Committee" means the family education savings program oversight committee established in
17 [section 6].

18 (5) "Designated beneficiary" means, with respect to an account, the person designated at the time
19 that the account is opened as the person whose higher education expenses are expected to be paid from
20 the account or if this person is replaced in accordance with [section 5], the individual replacing the former
21 designated beneficiary.

22 (6) "Financial institution" means any bank, commercial bank, national bank, savings bank, savings
23 and loan association, credit union, insurance company, trust company, mutual fund, or other similar entity
24 that is authorized to do business in this state.

25 (7) "Higher education institution" means:

26 (a) an institution described in the Higher Education Act of 1965, 20 U.S.C. 1141(a) and 1088(a);
27 or

28 (b) an area vocational educational school, as defined in section 521(3) of the Carl D. Perkins
29 Vocational Education Act, 20 U.S.C. 2471(3)(C) and (3)(D), that is located in this state.

30 (8) "Member of the family" means:

- 1 (a) an ancestor of a person;
- 2 (b) the spouse of a person;
- 3 (c) a lineal descendant, including a legally adopted child, of a person, of a person's spouse, or of
4 a parent of a person; or
- 5 (d) the spouse of any lineal descendant described in subsection (8)(c).
- 6 (9) "Nonqualified withdrawal" means a withdrawal from an account that is not:
- 7 (a) a qualified withdrawal;
- 8 (b) a withdrawal made as the result of the death or disability of the designated beneficiary of an
9 account;
- 10 (c) a withdrawal that is made on the account of a scholarship or the allowance or payment
11 described in section 135(d)(1)(B) or (d)(1)(C) of the Internal Revenue Code, 26 U.S.C. 135(d)(1)(B) or
12 (d)(1)(C), and that is received by the designated beneficiary; or
- 13 (d) a rollover or change of designated beneficiary.
- 14 (10) "Program" means the family education savings program established pursuant to [section 4].
15 The program must be structured to permit the long-term accumulation of savings that can be used to
16 finance all or a share of the costs of higher education.
- 17 (11) "Qualified higher education expenses" means tuition and fees required for enrollment or
18 attendance of a designated beneficiary at a higher education institution.
- 19 (12) "Qualified withdrawal" means a withdrawal from an account to pay the qualified higher
20 education expenses of the designated beneficiary of the account.

21

22 **NEW SECTION. Section 4. Program requirements -- application -- establishment of account --**
23 **qualified and nonqualified withdrawal -- penalties.** (1) A person who wishes to deposit money into an
24 account to pay the qualified higher education expenses of a designated beneficiary shall:

- 25 (a) complete an application on the form prescribed by the board that includes:
- 26 (i) the name, address, and social security number or employer identification number of the
27 contributor;
- 28 (ii) the name, address, and social security number of the account owner if the account owner is
29 not the contributor;
- 30 (iii) the name, address, and social security number of the designated beneficiary;

1 (iv) the certification relating to no excess contributions adopted by the board pursuant to [section
2 7]; and

3 (v) any other information required by the board;

4 (b) pay the one-time application fee established by the board;

5 (c) make the minimum contribution required by the board or by opening an account; and

6 (d) designate the type of account to be opened if more than one type of account is offered.

7 (2) A person shall make contributions to an opened account in cash.

8 (3) An account owner may withdraw all or part of the balance from an account under rules
9 prescribed by the board to enable the board or program manager to determine if a withdrawal is a
10 nonqualified withdrawal or a qualified withdrawal. The rules may require that:

11 (a) account owners seeking to make a qualified withdrawal or other withdrawal that is not a
12 nonqualified withdrawal shall provide certifications, copies of bills for qualified higher education expenses,
13 or other supporting material;

14 (b) qualified withdrawals from an account be made only by a check payable jointly to the
15 designated beneficiary and a higher education institution; and

16 (c) withdrawals not meeting certain requirements be treated as nonqualified withdrawals by the
17 program manager, and if these withdrawals are not nonqualified withdrawals, the account owner shall seek
18 refunds of penalties directly from the board.

19 (4) If a nonqualified withdrawal is made from an account, an amount equal to 10% of the portion
20 of the proposed withdrawal that would constitute income as determined in accordance with section 529
21 of the Internal Revenue Code, 26 U.S.C. 529, must be withheld as a penalty and paid to the board for use
22 in operating and marketing the program and for state student financial aid. A NONQUALIFIED
23 WITHDRAWAL CONSTITUTES INCOME FOR MONTANA PURPOSES TO THE EXTENT IT WAS PREVIOUSLY
24 DEDUCTED FROM INCOME IN CALCULATING MONTANA INDIVIDUAL INCOME TAXES.

25 (5) The board, by rule, shall increase the percentage of the penalty prescribed in subsection (4) or
26 change the basis of this penalty if the board determines that the amount of the penalty must be increased
27 to constitute a minimum penalty for purposes of qualifying the program as a qualified state tuition program
28 under section 529 of the Internal Revenue Code, 26 U.S.C. 529.

29 (6) The board may decrease the percentage of the penalty prescribed in subsection (4) if:

30 (a) the penalty is greater than is required to constitute a minimum penalty for purposes of qualifying

1 the program as a qualified state tuition program under section 529 of the Internal Revenue Code, 26 U.S.C.
2 529; or

3 (b) the penalty, when combined with other revenue generated under [sections 1 through 5 and 8
4 through 11], is producing more revenue than is required to cover the costs of operating and marketing the
5 program and to recover any costs not previously recovered.

6 (7) If an account owner makes a nonqualified withdrawal and a penalty amount is not withheld
7 pursuant to subsection (4) or the amount withheld was less than the amount required to be withheld under
8 that subsection for nonqualified withdrawals, the account owner shall pay:

9 (a) the unpaid portion of the penalty to the board at the same time that the account owner files
10 a federal and state income tax return for the taxable year of the withdrawal; or

11 (b) if the account owner does not file a return, the unpaid portion of the penalty on the due date
12 for federal and state income tax returns, including any authorized extensions.

13 (8) Each account must be maintained separately from each other account under the program.

14 (9) Separate records and accounting must be maintained for each account for each designated
15 beneficiary.

16 (10) A contributor to, account owner of, or designated beneficiary of an account may not direct
17 the investment of any contributions to any account or the earnings generated by the account and may not
18 pledge the interest of an account or use an interest in an account as security for a loan.

19 (11) If the board terminates the authority of a financial institution to hold accounts and accounts
20 must be moved from that financial institution to another financial institution, the board shall select the
21 financial institution and type of investment to which the balance of the account is moved unless the internal
22 revenue service provides guidance stating that allowing the account owner to select among several financial
23 institutions that are then contractors would not cause a plan to cease to be a qualified state tuition plan.

24 (12) If there is any distribution from an account to any person or for the benefit of any person
25 during a calendar year, the distribution must be reported to the internal revenue service and the account
26 owner or the designated beneficiary to the extent required by federal law.

27 (13) The financial institution shall provide statements to each account owner at least once each
28 year within 31 days after the 12-month period to which they relate. The statement must identify the
29 contributions made during a preceding 12-month period, the total contributions made through the end of
30 the period, the value of the account as of the end of this period, distributions made during this period, and

1 any other matters that the board requires be reported to the account owner.

2 (14) Statements and information returns relating to accounts must be prepared and filed to the
3 extent required by federal or state tax law OR BY ADMINISTRATIVE RULE.

4 (15) A state or local government or organizations described in section 501(c)(3) of the Internal
5 Revenue Code, 26 U.S.C. 501(c)(3), may, without designating a designated beneficiary, open and become
6 the account owner of an account to fund scholarships for persons whose identity will be determined after
7 an account is opened.

8

9 **NEW SECTION. Section 5. Changes in designated beneficiary.** (1) An account owner may change
10 the designated beneficiary of an account to an individual who is a member of the family of the former
11 designated beneficiary in accordance with procedures established by the board.

12 (2) If requested by an account owner, all or a portion of an account may be transferred to another
13 account of which the designated beneficiary is a member of the family of the designated beneficiary of the
14 transferee account.

15 (3) Changes in designated beneficiaries and rollovers under this section are not permitted if the
16 changes or rollovers would violate:

17 (a) the excess contributions provisions adopted by the board pursuant to [section 7]; or

18 (b) the investment choice provisions of [section 4(10)].

19

20 **NEW SECTION. Section 6. Family education savings program oversight committee -- membership**
21 **-- powers and duties.** (1) There is created a family education savings program oversight committee under
22 the authority of the board.

23 (2) The committee consists of seven members appointed by the governor to staggered 4-year
24 terms. The members must include:

25 (a) the commissioner of insurance or the commissioner's designee;

26 (b) the director of the department of commerce or the director's designee;

27 (c) the state treasurer or the state treasurer's designee;

28 (d) the presiding officer of the board or the presiding officer's designee; and

29 (e) three members of the general public, each of whom possesses knowledge, skill, and experience
30 in accounting, risk management, or investment management or as an actuary.

1 (3) The committee shall select a presiding officer and a vice presiding officer from among the
2 committee's membership.

3 (4) A majority of the membership constitutes a quorum for the transaction of business. The
4 committee shall meet at least once a year, with additional meetings called by the presiding officer.

5 (5) The committee:

6 (a) shall recommend financial institutions for approval by the board to act as the depositories and
7 managers of family education savings accounts pursuant to [section 4]; and

8 (b) may submit proposed policies to the board to assist in the implementation and administration
9 of [sections 1 through 5 and 8 through 11].

10 (6) The committee is allocated to the board for administrative purposes only, as prescribed in
11 2-15-121.

12 (7) Members of the committee must be compensated as provided in 2-15-124.

13 (8) The definitions in [section 3] apply to this section.

14

15 **NEW SECTION. Section 7. Board -- powers and duties.** (1) The board shall:

16 (a) retain professional services, if necessary, including services of accountants, auditors,
17 consultants, and other experts;

18 (b) seek rulings and other guidance relating to the program from the United States department of
19 the treasury and the internal revenue service;

20 (c) make changes to the program as required for the participants in the program to obtain the
21 federal income tax benefits or treatment provided by section 529 of the Internal Revenue Code, 26 U.S.C.
22 529, as amended;

23 (d) charge, impose, and collect administrative fees and service charges pursuant to any agreement,
24 contract, or transaction relating to the program;

25 (e) select the financial institution or institutions to act as the depository and manager of the program
26 pursuant to [section 8];

27 (f) on the recommendation of the committee, adopt rules to prevent contributions on behalf of a
28 designated beneficiary in excess of those necessary to pay the qualified higher education expenses of the
29 designated beneficiaries. The rules must address the following:

30 (i) procedures for aggregating the total balances of multiple accounts established for a designated

1 beneficiary;

2 (ii) the establishment of a maximum total balance that may be held in accounts for a designated
3 beneficiary;

4 (iii) requirements that persons who contribute to an account certify that to the best of their
5 knowledge, the balance in all qualified state tuition programs, as defined in section 529 of the Internal
6 Revenue Code, 26 U.S.C. 529, for the designated beneficiary does not exceed the lesser of:

7 (A) a maximum college savings amount established by the board; or

8 (B) the cost in current dollars of qualified higher education expenses that the contributor reasonably
9 anticipates the designated beneficiary will incur;

10 (iv) requirements that any excess balances with respect to a designated beneficiary be promptly
11 withdrawn in a nonqualified withdrawal or rolled over to another account in accordance with this section;
12 and

13 (g) adopt procedures as necessary to implement [sections 1 through 5 and 8 through 11].

14 (2) The definitions in [section 3] apply to this section.

15

16 **NEW SECTION. Section 8. Selection of financial institution as account depository and manager**

17 -- **contract -- termination.** (1) The board shall implement the program through the use of one or more
18 financial institutions to act as the depository and manager. Under the program, a person may establish
19 accounts at the depository.

20 (2) The committee shall solicit proposals from financial institutions to act as the depositories and
21 managers of the program. Financial institutions that submit proposals shall describe the financial
22 instruments that will be held in accounts.

23 (3) On the recommendation of the committee, the board shall select as program depositories and
24 managers the financial institution or institutions from among bidding financial institutions that demonstrate
25 the most advantageous combination, both to potential program participants and to this state, of:

26 (a) financial stability and integrity;

27 (b) the safety of the investment instruments being offered, taking into account any insurance
28 provided with respect to these instruments;

29 (c) the ability of the investment instruments to track estimated costs of higher education as
30 calculated by the board and provided by the financial institution to the account holder;

1 (d) the ability of the financial institutions, directly or through a subcontract, to satisfy
2 recordkeeping and reporting requirements;

3 (e) the financial institution's plan for promoting the program and the investment that it is willing
4 to make to promote the program;

5 (f) the fees, if any, proposed to be charged to persons for maintaining accounts;

6 (g) the minimum initial deposit and minimum contributions that the financial institution will require
7 and the willingness of the financial institution or its subcontractors to accept contributions through payroll
8 deduction plans and other deposit plans; and

9 (h) any other benefits to this state or its residents contained in the proposal, including an account
10 opening fee payable to the board by the account owner to cover expenses of operation of the program and
11 any additional fee offered by the financial institution for statewide program marketing by the board.

12 (4) The board shall enter into a contract with a financial institution or, except as provided in
13 subsection (5), into contracts with financial institutions to serve as depositories and program managers.

14 (5) The committee may select more than one financial institution and investment for the program
15 if:

16 (a) the internal revenue service has provided guidance that giving a contributor a choice of two or
17 more investment instruments under a state plan will not cause the plan to fail to qualify for favorable tax
18 treatment under section 529 of the Internal Revenue Code, 26 U.S.C. 529; and

19 (b) the committee concludes that the choice of instrument vehicles is in the best interest of
20 program participants and will not interfere with the promotion of the program.

21 (6) A program manager or its subcontractor shall:

22 (a) take action required to keep the program in compliance with its contract or the requirements
23 of [sections 1 through 5 and 8 through 11] to manage the program so that it is treated as a qualified state
24 tuition plan under section 529 of the Internal Revenue Code, 26 U.S.C. 529;

25 (b) keep adequate records of each account, keep each account segregated from each other
26 account, and provide the board with the information necessary to prepare statements required by [section
27 4(12) through (14)] or file these statements on behalf of the board;

28 (c) compile and total information contained in statements required to be prepared under [section
29 4(12) through (14)] and provide these compilations to the board;

30 (d) if there is more than one program manager, provide the board with the information to assist the

1 board in determining compliance with rules adopted by the board pursuant to [section 7];

2 (e) provide representatives of the board, including other contractors or other state agencies, access
3 to the books and records of the program manager to the extent needed to determine compliance with the
4 contract. At least once during the term of any contract, the board, its contractor, or the state agency
5 responsible for examination oversight of the program manager shall conduct an examination to the extent
6 needed to determine compliance with the contract.

7 (f) hold all accounts in trust for the benefit of this state and the account owner.

8 (7) A person may not circulate any description of the program, whether in writing or through the
9 use of any media, unless the board or its designee first approves the description.

10 (8) A contract executed between the board and a financial institution pursuant to this section must
11 be for a term of at least 3 years and not more than 7 years.

12 (9) If a contract executed between the board and a financial institution pursuant to this section is
13 not renewed, at the end of the term of the nonrenewed contract:

14 (a) accounts previously established and held in investment instruments at the financial institution
15 may not be terminated;

16 (b) additional contributions may be made to the accounts in existence at the time of nonrenewal
17 of a contract; and

18 (c) new accounts may not be placed with that financial institution unless a new contract is
19 executed.

20 (10) The board may terminate a contract with a financial institution at any time for good cause on
21 the recommendation of the committee. If a contract is terminated pursuant to this subsection, the board
22 shall take custody of accounts held at that financial institution and shall seek to promptly transfer the
23 accounts to another financial institution that is selected as a program manager and into investment
24 instruments as similar as possible to the original investments.

25

26 **NEW SECTION. Section 9. Higher education expenses -- exemption from taxable income.** A
27 person may in any year deposit into an individual trust or savings account up to \$3,000 that is deductible
28 for tax purposes under 15-30-111(2)(k) to pay the qualified higher education expenses for the benefit of
29 a designated beneficiary.

30

1 **NEW SECTION. Section 10. Scholarships and financial aid provisions -- exceptions.** (1) Except
2 as provided in subsection (2), a student loan program, student grant program, or other financial assistance
3 program established or administered by the state or a financial assistance program administered by a
4 state-supported college or university must treat the balance in an account of which the student is a
5 designated beneficiary as if it were an asset of the parent of the designated beneficiary and not as a
6 scholarship or grant or as an asset of the student for determining a student's or parent's income, assets,
7 or financial need.

8 (2) This section does not apply if:

9 (a) federal law requires all or a portion of the amount in an account to be taken into account in a
10 different manner;

11 (b) federal benefits could be lost if all or a portion of the amount in an account is not taken into
12 account in a different manner; or

13 (c) a specific grant establishing a financial assistance program requires that all or a portion of the
14 amount in an account be taken into account.

15
16 **NEW SECTION. Section 11. Limitations.** (1) [Sections 1 through 5 and 8 through 11] may not
17 be construed to:

18 (a) give any designated beneficiary any rights or legal interest with respect to an account unless
19 the designated beneficiary is the account owner;

20 (b) guarantee that a designated beneficiary will be admitted to a higher education institution or be
21 allowed to continue enrollment at or graduate from a higher education institution located in this state after
22 admission;

23 (c) establish state residency for a person merely because the person is a designated beneficiary;
24 or

25 (d) guarantee that amounts saved pursuant to the program will be sufficient to cover the qualified
26 higher education expenses of a designated beneficiary.

27 (2) [Sections 1 through 5 and 8 through 11] do not establish any obligation of this state or any
28 agency or instrumentality of the state to guarantee for the benefit of any account owner, contributor to an
29 account, or designated beneficiary:

30 (a) the return of any amounts contributed to an account;

1 (b) the rate of interest or other return on any account; or

2 (c) the payment of interest or other return on any account.

3 (3) Under rules adopted by the board, each contract, application, deposit slip, or other document
4 that may be used in connection with a contribution to an account must clearly indicate that the account
5 is not insured by the state and that the principal deposited or the investment return is not guaranteed by
6 the state.

7

8 **Section 12.** Section 15-30-111, MCA, is amended to read:

9 **"15-30-111. Adjusted gross income.** (1) Adjusted gross income is the taxpayer's federal income
10 tax adjusted gross income as defined in section 62 of the Internal Revenue Code of 1954, 26 U.S.C. 62,
11 as that section may be labeled or amended, and in addition includes the following:

12 (a) (i) interest received on obligations of another state or territory or county, municipality, district,
13 or other political subdivision of another state, except to the extent that the interest is exempt from taxation
14 by Montana under federal law;

15 (ii) exempt-interest dividends as defined in section 852(b)(5) of the Internal Revenue Code of 1986,
16 26 U.S.C. 852(b)(5), as that section may be amended or renumbered, that are attributable to the interest
17 referred to in subsection (1)(a)(i);

18 (b) refunds received of federal income tax, to the extent that the deduction of the tax resulted in
19 a reduction of Montana income tax liability;

20 (c) that portion of a shareholder's income under subchapter S. of Chapter 1 of the Internal Revenue
21 Code of 1954 that has been reduced by any federal taxes paid by the subchapter S. corporation on the
22 income;

23 (d) depreciation or amortization taken on a title plant as defined in 33-25-105(15); and

24 (e) the recovery during the tax year of an amount deducted in any prior tax year to the extent that
25 the amount recovered reduced the taxpayer's Montana income tax in the year deducted.

26 (2) Notwithstanding the provisions of the federal Internal Revenue Code of 1954, as labeled or
27 amended, adjusted gross income does not include the following, which are exempt from taxation under this
28 chapter:

29 (a) (i) all interest income from obligations of the United States government, the state of Montana,
30 county, municipality, district, or other political subdivision of the state and any other interest income that

- 1 is exempt from taxation by Montana under federal law;
- 2 (ii) exempt-interest dividends as defined in section 852(b)(5) of the Internal Revenue Code of 1986,
3 26 U.S.C. 852(b)(5), as that section may be amended or renumbered, that are attributable to the interest
4 referred to in subsection (2)(a)(i);
- 5 (b) interest income earned by a taxpayer who is 65 years of age or older in a tax year up to and
6 including \$800 for a taxpayer filing a separate return and \$1,600 for each joint return;
- 7 (c) (i) except as provided in subsection (2)(c)(ii), the first \$3,600 of all pension and annuity income
8 received as defined in 15-30-101;
- 9 (ii) for pension and annuity income described under subsection (2)(c)(i), as follows:
- 10 (A) each taxpayer filing singly, head of household, or married filing separately shall reduce the total
11 amount of the exclusion provided in subsection (2)(c)(i) by \$2 for every \$1 of federal adjusted gross income
12 in excess of \$30,000 as shown on the taxpayer's return;
- 13 (B) in the case of married taxpayers filing jointly, if both taxpayers are receiving pension or annuity
14 income or if only one taxpayer is receiving pension or annuity income, the exclusion claimed as provided
15 in subsection (2)(c)(i) must be reduced by \$2 for every \$1 of federal adjusted gross income in excess of
16 \$30,000 as shown on their joint return;
- 17 (d) all Montana income tax refunds or tax refund credits;
- 18 (e) gain required to be recognized by a liquidating corporation under 15-31-113(1)(a)(ii);
- 19 (f) all tips or gratuities that are covered by section 3402(k) or service charges that are covered by
20 section 3401 of the Internal Revenue Code of 1954, 26 U.S.C. 3402(k) or 3401, as amended and
21 applicable on January 1, 1983, received by persons for services rendered by them to patrons of premises
22 licensed to provide food, beverage, or lodging;
- 23 (g) all benefits received under the workers' compensation laws;
- 24 (h) all health insurance premiums paid by an employer for an employee if attributed as income to
25 the employee under federal law;
- 26 (i) all money received because of a settlement agreement or judgment in a lawsuit brought against
27 a manufacturer or distributor of "agent orange" for damages resulting from exposure to "agent orange";
- 28 (j) principal and income in a medical care savings account established in accordance with
29 15-61-201 or withdrawn from an account for eligible medical expenses, as defined in 15-61-102, of the
30 taxpayer or a dependent of the taxpayer or for the long-term care of the taxpayer or a dependent of the

1 taxpayer; and

2 ~~(k) principal and income in MONEY, NOT EXCEEDING \$3,000 FOR EACH TAXPAYER,~~
 3 ~~CONTRIBUTED TO a family education savings program account established in accordance with [section 4]~~
 4 ~~or;~~

5 (L) PRINCIPAL withdrawn from an account for qualified higher education expenses, as defined in
 6 [section 3], for a designated beneficiary of the taxpayer; and

7 ~~(k)(M)~~ the recovery during the tax year of any amount deducted in any prior tax year to the
 8 extent that the recovered amount did not reduce the taxpayer's Montana income tax in the year deducted.

9 (3) A shareholder of a DISC that is exempt from the corporation license tax under 15-31-102(1)(i)
 10 shall include in the shareholder's adjusted gross income the earnings and profits of the DISC in the same
 11 manner as provided by section 995 of the Internal Revenue Code, 26 U.S.C. 995, for all periods for which
 12 the DISC election is effective.

13 (4) A taxpayer who, in determining federal adjusted gross income, has reduced the taxpayer's
 14 business deductions by an amount for wages and salaries for which a federal tax credit was elected under
 15 ~~section 44B~~ sections 38 and 51(a) of the Internal Revenue Code of 1954, as ~~that section~~ those sections
 16 may be labeled or amended, is allowed to deduct the amount of the wages and salaries paid regardless of
 17 the credit taken. The deduction must be made in the year the wages and salaries were used to compute
 18 the credit. In the case of a partnership or small business corporation, the deduction must be made to
 19 determine the amount of income or loss of the partnership or small business corporation.

20 (5) Married taxpayers filing a joint federal return who are required to include part of their social
 21 security benefits or part of their tier 1 railroad retirement benefits in federal adjusted gross income may split
 22 the federal base used in calculation of federal taxable social security benefits or federal taxable tier 1
 23 railroad retirement benefits when they file separate Montana income tax returns. The federal base must be
 24 split equally on the Montana return.

25 (6) A taxpayer receiving retirement disability benefits who has not attained age 65 by the end of
 26 the tax year and who has retired as permanently and totally disabled may exclude from adjusted gross
 27 income up to \$100 per week received as wages or payments in lieu of wages for a period during which the
 28 employee is absent from work due to the disability. If the adjusted gross income before this exclusion and
 29 before application of the two-earner married couple deduction exceeds \$15,000, the excess reduces the
 30 exclusion by an equal amount. This limitation affects the amount of exclusion, but not the taxpayer's

1 eligibility for the exclusion. If eligible, married individuals shall apply the exclusion separately, but the
2 limitation for income exceeding \$15,000 is determined with respect to the spouses on their combined
3 adjusted gross income. For the purpose of this subsection, permanently and totally disabled means unable
4 to engage in any substantial gainful activity by reason of any medically determined physical or mental
5 impairment lasting or expected to last at least 12 months. (Subsection (2)(f) terminates on occurrence of
6 contingency--sec. 3, Ch. 634, L. 1983.)"

7

8 **NEW SECTION.** **Section 13. Implementation of staggered terms.** (1) To implement the
9 staggered-term system provided for in [section 6], the first terms of the members are as follows:

10 (a) one member shall serve a 1-year term;

11 (b) two members shall serve 2-year terms;

12 (c) two members shall serve 3-year terms; and

13 (d) two members shall serve 4-year terms.

14 (2) Upon expiration of the terms provided for in subsection (1), each member shall serve a 4-year
15 term.

16

17 **NEW SECTION.** **Section 14. Codification instruction.** (1) [Sections 1 through 5 and 8 through 11]
18 are intended to be codified as an integral part of Title 15, and the provisions of Title 15 apply to [sections
19 1 through 5 and 8 through 11].

20 (2) [Sections 6 and 7] are intended to be codified as an integral part of Title 20, chapter 25, and
21 the provisions of Title 20, chapter 25, apply to [sections 6 and 7].

22

23 **NEW SECTION.** **Section 15. Effective date.** [This act] is effective July 1, 1997.

24

-END-

1 HOUSE BILL NO. 536

2 INTRODUCED BY BOHLINGER

3

4 A BILL FOR AN ACT ENTITLED: "AN ACT ESTABLISHING THE FAMILY EDUCATION SAVINGS ACT;
5 ESTABLISHING A FAMILY EDUCATION SAVINGS PROGRAM OVERSIGHT COMMITTEE; ESTABLISHING
6 PROCEDURES AUTHORIZING A PERSON TO MAKE CONTRIBUTIONS TO ACCOUNTS THAT ARE
7 ESTABLISHED TO PAY HIGHER EDUCATION EXPENSES FOR A DESIGNATED BENEFICIARY OF AN
8 ACCOUNT OWNER; REQUIRING THE BOARD OF REGENTS TO IMPLEMENT THE PROGRAM AND
9 AUTHORIZING THE BOARD TO SELECT FINANCIAL INSTITUTIONS TO ACT AS DEPOSITORIES AND
10 PROGRAM MANAGERS, USING SPECIFIED BIDDING CRITERIA; PROVIDING FOR THE FEDERAL DEFERRAL
11 OF TAXES ON INVESTMENT EARNINGS CONTRIBUTED TO AN ACCOUNT; PROVIDING A DEDUCTION
12 FROM STATE INCOME TAX PURPOSES OF UP TO \$3,000 ANNUALLY FOR CONTRIBUTIONS TO AN
13 ACCOUNT; REQUIRING ANNUAL REPORTING OF CONTRIBUTIONS RECEIVED TO THE INTERNAL
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17 CHANGE IN DESIGNATED BENEFICIARY BY AN ACCOUNT OWNER UNDER CERTAIN CONDITIONS;
18 AUTHORIZING THE WITHDRAWAL OF ALL OR PART OF THE BALANCE OF AN ACCOUNT PURSUANT TO
19 BOARD OF REGENT RULES; PROHIBITING USE OF ACCOUNT INTEREST AS LOAN SECURITY; AMENDING
20 SECTION 15-30-111, MCA; AND PROVIDING AN EFFECTIVE DATE."

21

22 BE IT ENACTED BY THE LEGISLATURE OF THE STATE OF MONTANA:

**THERE ARE NO CHANGES IN THIS BILL AND IT WILL NOT BE
REPRINTED. PLEASE REFER TO SECOND READING COPY
(YELLOW) FOR COMPLETE TEXT.**

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 20 SECTION 15-30-111, MCA; AND PROVIDING AN EFFECTIVE DATE."

21

22 BE IT ENACTED BY THE LEGISLATURE OF THE STATE OF MONTANA:

23

24 NEW SECTION. **Section 1. Short title.** [Sections 1 through 5 and 8 through 11] may be cited as
 25 the "Family Education Savings Act".

26

27 NEW SECTION. **Section 2. Purpose.** (1) It is the intent of the legislature to establish the Family
 28 Education Savings Act in recognition that the general welfare and well-being of the state of Montana are
 29 directly related to the educational levels and skills of its citizens. A vital and valid public purpose of the
 30 state of Montana is served by the establishment and implementation of a program that will encourage and

1 make possible the attainment of an accessible, affordable postsecondary education by the greatest number
2 of citizens through a savings program.

3 (2) The legislature further intends that the board achieve this purpose most effectively through a
4 public-private partnership using selected financial institutions to serve as depositories for individuals'
5 postsecondary education savings accounts.

6

7 **NEW SECTION. Section 3. Definitions.** As used in [sections 1 through 5 and 8 through 11], the
8 following definitions apply:

9 (1) "Account" means an individual trust account or savings account established under [sections 1
10 through 5 and 8 through 11].

11 (2) "Account owner" means the person designated at the time that an account is opened as having
12 the right to withdraw money from the account before the account is disbursed to or for the benefit of the
13 designated beneficiary.

14 (3) "Board" means the board of regents of higher education established by Article X, section 9,
15 subsection (2), of the Montana constitution and 2-15-1505.

16 (4) "Committee" means the family education savings program oversight committee established in
17 [section 6].

18 (5) "Designated beneficiary" means, with respect to an account, the person designated at the time
19 that the account is opened as the person whose higher education expenses are expected to be paid from
20 the account or if this person is replaced in accordance with [section 5], the individual replacing the former
21 designated beneficiary.

22 (6) "Financial institution" means any bank, commercial bank, national bank, savings bank, savings
23 and loan association, credit union, insurance company, trust company, mutual fund, or other similar entity
24 that is authorized to do business in this state.

25 (7) "Higher education institution" means:

26 (a) an institution described in the Higher Education Act of 1965, 20 U.S.C. 1141(a) and 1088(a);

27 or

28 (b) an area vocational educational school, as defined in section 521(3) of the Carl D. Perkins
29 Vocational Education Act, 20 U.S.C. 2471(3)(C) and (3)(D), that is located in this state.

30 (8) "Member of the family" means:

- 1 (a) an ancestor of a person;
- 2 (b) the spouse of a person;
- 3 (c) a lineal descendant, including a legally adopted child, of a person, of a person's spouse, or of
4 a parent of a person; or
- 5 (d) the spouse of any lineal descendant described in subsection (8)(c).
- 6 (9) "Nonqualified withdrawal" means a withdrawal from an account that is not:
- 7 (a) a qualified withdrawal;
- 8 (b) a withdrawal made as the result of the death or disability of the designated beneficiary of an
9 account;
- 10 (c) a withdrawal that is made on the account of a scholarship or the allowance or payment
11 described in section 135(d)(1)(B) or (d)(1)(C) of the Internal Revenue Code, 26 U.S.C. 135(d)(1)(B) or
12 (d)(1)(C), and that is received by the designated beneficiary; or
- 13 (d) a rollover or change of designated beneficiary.
- 14 (10) "Program" means the family education savings program established pursuant to [section 4].
15 The program must be structured to permit the long-term accumulation of savings that can be used to
16 finance all or a share of the costs of higher education.
- 17 (11) "Qualified higher education expenses" means tuition and fees required for enrollment or
18 attendance of a designated beneficiary at a higher education institution.
- 19 (12) "Qualified withdrawal" means a withdrawal from an account to pay the qualified higher
20 education expenses of the designated beneficiary of the account.
- 21
- 22 **NEW SECTION. Section 4. Program requirements -- application -- establishment of account --**
23 **qualified and nonqualified withdrawal -- penalties.** (1) A person who wishes to deposit money into an
24 account to pay the qualified higher education expenses of a designated beneficiary shall:
- 25 (a) complete an application on the form prescribed by the board that includes:
- 26 (i) the name, address, and social security number or employer identification number of the
27 contributor;
- 28 (ii) the name, address, and social security number of the account owner if the account owner is
29 not the contributor;
- 30 (iii) the name, address, and social security number of the designated beneficiary;

1 (iv) the certification relating to no excess contributions adopted by the board pursuant to [section
2 7]; and

3 (v) any other information required by the board;

4 (b) pay the one-time application fee established by the board;

5 (c) make the minimum contribution required by the board or by opening an account; and

6 (d) designate the type of account to be opened if more than one type of account is offered.

7 (2) A person shall make contributions to an opened account in cash.

8 (3) An account owner may withdraw all or part of the balance from an account under rules
9 prescribed by the board to enable the board or program manager to determine if a withdrawal is a
10 nonqualified withdrawal or a qualified withdrawal. The rules may require that:

11 (a) account owners seeking to make a qualified withdrawal or other withdrawal that is not a
12 nonqualified withdrawal shall provide certifications, copies of bills for qualified higher education expenses,
13 or other supporting material;

14 (b) qualified withdrawals from an account be made only by a check payable jointly to the
15 designated beneficiary and a higher education institution; and

16 (c) withdrawals not meeting certain requirements be treated as nonqualified withdrawals by the
17 program manager, and if these withdrawals are not nonqualified withdrawals, the account owner shall seek
18 refunds of penalties directly from the board.

19 (4) If a nonqualified withdrawal is made from an account, an amount equal to 10% of the portion
20 of the proposed withdrawal that would constitute income as determined in accordance with section 529
21 of the Internal Revenue Code, 26 U.S.C. 529, must be withheld as a penalty and paid to the board for use
22 in operating and marketing the program and for state student financial aid. A NONQUALIFIED
23 WITHDRAWAL CONSTITUTES INCOME FOR MONTANA PURPOSES TO THE EXTENT IT WAS PREVIOUSLY
24 DEDUCTED FROM INCOME IN CALCULATING MONTANA INDIVIDUAL INCOME TAXES.

25 (5) The board, by rule, shall increase the percentage of the penalty prescribed in subsection (4) or
26 change the basis of this penalty if the board determines that the amount of the penalty must be increased
27 to constitute a minimum penalty for purposes of qualifying the program as a qualified state tuition program
28 under section 529 of the Internal Revenue Code, 26 U.S.C. 529.

29 (6) The board may decrease the percentage of the penalty prescribed in subsection (4) if:

30 (a) the penalty is greater than is required to constitute a minimum penalty for purposes of qualifying

1 the program as a qualified state tuition program under section 529 of the Internal Revenue Code, 26 U.S.C.
2 529; or

3 (b) the penalty, when combined with other revenue generated under [sections 1 through 5 and 8
4 through 11], is producing more revenue than is required to cover the costs of operating and marketing the
5 program and to recover any costs not previously recovered.

6 (7) If an account owner makes a nonqualified withdrawal and a penalty amount is not withheld
7 pursuant to subsection (4) or the amount withheld was less than the amount required to be withheld under
8 that subsection for nonqualified withdrawals, the account owner shall pay:

9 (a) the unpaid portion of the penalty to the board at the same time that the account owner files
10 a federal and state income tax return for the taxable year of the withdrawal; or

11 (b) if the account owner does not file a return, the unpaid portion of the penalty on the due date
12 for federal and state income tax returns, including any authorized extensions.

13 (8) Each account must be maintained separately from each other account under the program.

14 (9) Separate records and accounting must be maintained for each account for each designated
15 beneficiary.

16 (10) A contributor to, account owner of, or designated beneficiary of an account may not direct
17 the investment of any contributions to any account or the earnings generated by the account and may not
18 pledge the interest of an account or use an interest in an account as security for a loan.

19 (11) If the board terminates the authority of a financial institution to hold accounts and accounts
20 must be moved from that financial institution to another financial institution, the board shall select the
21 financial institution and type of investment to which the balance of the account is moved unless the internal
22 revenue service provides guidance stating that allowing the account owner to select among several financial
23 institutions that are then contractors would not cause a plan to cease to be a qualified state tuition plan.

24 (12) If there is any distribution from an account to any person or for the benefit of any person
25 during a calendar year, the distribution must be reported to the internal revenue service and the account
26 owner or the designated beneficiary to the extent required by federal law.

27 (13) The financial institution shall provide statements to each account owner at least once each
28 year within 31 days after the 12-month period to which they relate. The statement must identify the
29 contributions made during a preceding 12-month period, the total contributions made through the end of
30 the period, the value of the account as of the end of this period, distributions made during this period, and

1 any other matters that the board requires be reported to the account owner.

2 (14) Statements and information returns relating to accounts must be prepared and filed to the
3 extent required by federal or state tax law OR BY ADMINISTRATIVE RULE.

4 (15) A state or local government or organizations described in section 501(c)(3) of the Internal
5 Revenue Code, 26 U.S.C. 501(c)(3), may, without designating a designated beneficiary, open and become
6 the account owner of an account to fund scholarships for persons whose identity will be determined after
7 an account is opened.

8

9 **NEW SECTION. Section 5. Changes in designated beneficiary.** (1) An account owner may change
10 the designated beneficiary of an account to an individual who is a member of the family of the former
11 designated beneficiary in accordance with procedures established by the board.

12 (2) If requested by an account owner, all or a portion of an account may be transferred to another
13 account of which the designated beneficiary is a member of the family of the designated beneficiary of the
14 transferee account.

15 (3) Changes in designated beneficiaries and rollovers under this section are not permitted if the
16 changes or rollovers would violate:

17 (a) the excess contributions provisions adopted by the board pursuant to [section 7]; or

18 (b) the investment choice provisions of [section 4(10)].

19

20 **NEW SECTION. Section 6. Family education savings program oversight committee -- membership**
21 **-- powers and duties.** (1) There is created a family education savings program oversight committee under
22 the authority of the board.

23 (2) The committee consists of seven members appointed by the governor to staggered 4-year
24 terms. The members must include:

25 (a) the commissioner of insurance or the commissioner's designee;

26 (b) the director of the department of commerce or the director's designee;

27 (c) the state treasurer or the state treasurer's designee;

28 (d) the presiding officer of the board or the presiding officer's designee; and

29 (e) three members of the general public, each of whom possesses knowledge, skill, and experience
30 in accounting, risk management, or investment management or as an actuary.

1 (3) The committee shall select a presiding officer and a vice presiding officer from among the
2 committee's membership.

3 (4) A majority of the membership constitutes a quorum for the transaction of business. The
4 committee shall meet at least once a year, with additional meetings called by the presiding officer.

5 (5) The committee:

6 (a) shall recommend financial institutions for approval by the board to act as the depositories and
7 managers of family education savings accounts pursuant to [section 4]; and

8 (b) may submit proposed policies to the board to assist in the implementation and administration
9 of [sections 1 through 5 and 8 through 11].

10 (6) The committee is allocated to the board for administrative purposes only, as prescribed in
11 2-15-121.

12 (7) Members of the committee must be compensated as provided in 2-15-124.

13 (8) The definitions in [section 3] apply to this section.

14

15 **NEW SECTION. Section 7. Board -- powers and duties.** (1) The board shall:

16 (a) retain professional services, if necessary, including services of accountants, auditors,
17 consultants, and other experts;

18 (b) seek rulings and other guidance relating to the program from the United States department of
19 the treasury and the internal revenue service;

20 (c) make changes to the program as required for the participants in the program to obtain the
21 federal income tax benefits or treatment provided by section 529 of the Internal Revenue Code, 26 U.S.C.
22 529, as amended;

23 (d) charge, impose, and collect administrative fees and service charges pursuant to any agreement,
24 contract, or transaction relating to the program;

25 (e) select the financial institution or institutions to act as the depository and manager of the program
26 pursuant to [section 8];

27 (f) on the recommendation of the committee, adopt rules to prevent contributions on behalf of a
28 designated beneficiary in excess of those necessary to pay the qualified higher education expenses of the
29 designated beneficiaries. The rules must address the following:

30 (i) procedures for aggregating the total balances of multiple accounts established for a designated

1 beneficiary;

2 (ii) the establishment of a maximum total balance that may be held in accounts for a designated
3 beneficiary;

4 (iii) requirements that persons who contribute to an account certify that to the best of their
5 knowledge, the balance in all qualified state tuition programs, as defined in section 529 of the Internal
6 Revenue Code, 26 U.S.C. 529, for the designated beneficiary does not exceed the lesser of:

7 (A) a maximum college savings amount established by the board; or

8 (B) the cost in current dollars of qualified higher education expenses that the contributor reasonably
9 anticipates the designated beneficiary will incur;

10 (iv) requirements that any excess balances with respect to a designated beneficiary be promptly
11 withdrawn in a nonqualified withdrawal or rolled over to another account in accordance with this section;
12 and

13 (g) adopt procedures as necessary to implement [sections 1 through 5 and 8 through 11].

14 (2) The definitions in [section 3] apply to this section.

15

16 **NEW SECTION. Section 8. Selection of financial institution as account depository and manager**

17 **-- contract -- termination.** (1) The board shall implement the program through the use of one or more
18 financial institutions to act as the depository and manager. Under the program, a person may establish
19 accounts at the depository.

20 (2) The committee shall solicit proposals from financial institutions to act as the depositories and
21 managers of the program. Financial institutions that submit proposals shall describe the financial
22 instruments that will be held in accounts.

23 (3) On the recommendation of the committee, the board shall select as program depositories and
24 managers the financial institution or institutions from among bidding financial institutions that demonstrate
25 the most advantageous combination, both to potential program participants and to this state, of:

26 (a) financial stability and integrity;

27 (b) the safety of the investment instruments being offered, taking into account any insurance
28 provided with respect to these instruments;

29 (c) the ability of the investment instruments to track estimated costs of higher education as
30 calculated by the board and provided by the financial institution to the account holder;

1 (d) the ability of the financial institutions, directly or through a subcontract, to satisfy
2 recordkeeping and reporting requirements;

3 (e) the financial institution's plan for promoting the program and the investment that it is willing
4 to make to promote the program;

5 (f) the fees, if any, proposed to be charged to persons for maintaining accounts;

6 (g) the minimum initial deposit and minimum contributions that the financial institution will require
7 and the willingness of the financial institution or its subcontractors to accept contributions through payroll
8 deduction plans and other deposit plans; and

9 (h) any other benefits to this state or its residents contained in the proposal, including an account
10 opening fee payable to the board by the account owner to cover expenses of operation of the program and
11 any additional fee offered by the financial institution for statewide program marketing by the board.

12 (4) The board shall enter into a contract with a financial institution or, except as provided in
13 subsection (5), into contracts with financial institutions to serve as depositories and program managers.

14 (5) The committee may select more than one financial institution and investment for the program
15 if:

16 (a) the internal revenue service has provided guidance that giving a contributor a choice of two or
17 more investment instruments under a state plan will not cause the plan to fail to qualify for favorable tax
18 treatment under section 529 of the Internal Revenue Code, 26 U.S.C. 529; and

19 (b) the committee concludes that the choice of instrument vehicles is in the best interest of
20 program participants and will not interfere with the promotion of the program.

21 (6) A program manager or its subcontractor shall:

22 (a) take action required to keep the program in compliance with its contract or the requirements
23 of [sections 1 through 5 and 8 through 11] to manage the program so that it is treated as a qualified state
24 tuition plan under section 529 of the Internal Revenue Code, 26 U.S.C. 529;

25 (b) keep adequate records of each account, keep each account segregated from each other
26 account, and provide the board with the information necessary to prepare statements required by [section
27 4(12) through (14)] or file these statements on behalf of the board;

28 (c) compile and total information contained in statements required to be prepared under [section
29 4(12) through (14)] and provide these compilations to the board;

30 (d) if there is more than one program manager, provide the board with the information to assist the

1 board in determining compliance with rules adopted by the board pursuant to [section 7];

2 (e) provide representatives of the board, including other contractors or other state agencies, access
3 to the books and records of the program manager to the extent needed to determine compliance with the
4 contract. At least once during the term of any contract, the board, its contractor, or the state agency
5 responsible for examination oversight of the program manager shall conduct an examination to the extent
6 needed to determine compliance with the contract.

7 (f) hold all accounts in trust for the benefit of this state and the account owner.

8 (7) A person may not circulate any description of the program, whether in writing or through the
9 use of any media, unless the board or its designee first approves the description.

10 (8) A contract executed between the board and a financial institution pursuant to this section must
11 be for a term of at least 3 years and not more than 7 years.

12 (9) If a contract executed between the board and a financial institution pursuant to this section is
13 not renewed, at the end of the term of the nonrenewed contract:

14 (a) accounts previously established and held in investment instruments at the financial institution
15 may not be terminated;

16 (b) additional contributions may be made to the accounts in existence at the time of nonrenewal
17 of a contract; and

18 (c) new accounts may not be placed with that financial institution unless a new contract is
19 executed.

20 (10) The board may terminate a contract with a financial institution at any time for good cause on
21 the recommendation of the committee. If a contract is terminated pursuant to this subsection, the board
22 shall take custody of accounts held at that financial institution and shall seek to promptly transfer the
23 accounts to another financial institution that is selected as a program manager and into investment
24 instruments as similar as possible to the original investments.

25

26 **NEW SECTION. Section 9. Higher education expenses -- exemption from taxable income.** A
27 person may in any year deposit into an individual trust or savings account up to \$3,000 that is deductible
28 for tax purposes under 15-30-111(2)(k) to pay the qualified higher education expenses for the benefit of
29 a designated beneficiary.

30

1 **NEW SECTION. Section 10. Scholarships and financial aid provisions -- exceptions.** (1) Except
2 as provided in subsection (2), a student loan program, student grant program, or other financial assistance
3 program established or administered by the state or a financial assistance program administered by a
4 state-supported college or university must treat the balance in an account of which the student is a
5 designated beneficiary as if it were an asset of the parent of the designated beneficiary and not as a
6 scholarship or grant or as an asset of the student for determining a student's or parent's income, assets,
7 or financial need.

8 (2) This section does not apply if:

9 (a) federal law requires all or a portion of the amount in an account to be taken into account in a
10 different manner;

11 (b) federal benefits could be lost if all or a portion of the amount in an account is not taken into
12 account in a different manner; or

13 (c) a specific grant establishing a financial assistance program requires that all or a portion of the
14 amount in an account be taken into account.

15
16 **NEW SECTION. Section 11. Limitations.** (1) [Sections 1 through 5 and 8 through 11] may not
17 be construed to:

18 (a) give any designated beneficiary any rights or legal interest with respect to an account unless
19 the designated beneficiary is the account owner;

20 (b) guarantee that a designated beneficiary will be admitted to a higher education institution or be
21 allowed to continue enrollment at or graduate from a higher education institution located in this state after
22 admission;

23 (c) establish state residency for a person merely because the person is a designated beneficiary;
24 or

25 (d) guarantee that amounts saved pursuant to the program will be sufficient to cover the qualified
26 higher education expenses of a designated beneficiary.

27 (2) [Sections 1 through 5 and 8 through 11] do not establish any obligation of this state or any
28 agency or instrumentality of the state to guarantee for the benefit of any account owner, contributor to an
29 account, or designated beneficiary:

30 (a) the return of any amounts contributed to an account;

1 (b) the rate of interest or other return on any account; or

2 (c) the payment of interest or other return on any account.

3 (3) Under rules adopted by the board, each contract, application, deposit slip, or other document
4 that may be used in connection with a contribution to an account must clearly indicate that the account
5 is not insured by the state and that the principal deposited or the investment return is not guaranteed by
6 the state.

7

8 **Section 12.** Section 15-30-111, MCA, is amended to read:

9 **"15-30-111. Adjusted gross income.** (1) Adjusted gross income is the taxpayer's federal income
10 tax adjusted gross income as defined in section 62 of the Internal Revenue Code of 1954, 26 U.S.C. 62,
11 as that section may be labeled or amended, and in addition includes the following:

12 (a) (i) interest received on obligations of another state or territory or county, municipality, district,
13 or other political subdivision of another state, except to the extent that the interest is exempt from taxation
14 by Montana under federal law;

15 (ii) exempt-interest dividends as defined in section 852(b)(5) of the Internal Revenue Code of 1986,
16 26 U.S.C. 852(b)(5), as that section may be amended or renumbered, that are attributable to the interest
17 referred to in subsection (1)(a)(i);

18 (b) refunds received of federal income tax, to the extent that the deduction of the tax resulted in
19 a reduction of Montana income tax liability;

20 (c) that portion of a shareholder's income under subchapter S. of Chapter 1 of the Internal Revenue
21 Code of 1954 that has been reduced by any federal taxes paid by the subchapter S. corporation on the
22 income;

23 (d) depreciation or amortization taken on a title plant as defined in 33-25-105(15); and

24 (e) the recovery during the tax year of an amount deducted in any prior tax year to the extent that
25 the amount recovered reduced the taxpayer's Montana income tax in the year deducted.

26 (2) Notwithstanding the provisions of the federal Internal Revenue Code of 1954, as labeled or
27 amended, adjusted gross income does not include the following, which are exempt from taxation under this
28 chapter:

29 (a) (i) all interest income from obligations of the United States government, the state of Montana,
30 county, municipality, district, or other political subdivision of the state and any other interest income that

1 is exempt from taxation by Montana under federal law;

2 (ii) exempt-interest dividends as defined in section 852(b)(5) of the Internal Revenue Code of 1986,
3 26 U.S.C. 852(b)(5), as that section may be amended or renumbered, that are attributable to the interest
4 referred to in subsection (2)(a)(i);

5 (b) interest income earned by a taxpayer who is 65 years of age or older in a tax year up to and
6 including \$800 for a taxpayer filing a separate return and \$1,600 for each joint return;

7 (c) (i) except as provided in subsection (2)(c)(ii), the first \$3,600 of all pension and annuity income
8 received as defined in 15-30-101;

9 (ii) for pension and annuity income described under subsection (2)(c)(i), as follows:

10 (A) each taxpayer filing singly, head of household, or married filing separately shall reduce the total
11 amount of the exclusion provided in subsection (2)(c)(i) by \$2 for every \$1 of federal adjusted gross income
12 in excess of \$30,000 as shown on the taxpayer's return;

13 (B) in the case of married taxpayers filing jointly, if both taxpayers are receiving pension or annuity
14 income or if only one taxpayer is receiving pension or annuity income, the exclusion claimed as provided
15 in subsection (2)(c)(i) must be reduced by \$2 for every \$1 of federal adjusted gross income in excess of
16 \$30,000 as shown on their joint return;

17 (d) all Montana income tax refunds or tax refund credits;

18 (e) gain required to be recognized by a liquidating corporation under 15-31-113(1)(a)(ii);

19 (f) all tips or gratuities that are covered by section 3402(k) or service charges that are covered by
20 section 3401 of the Internal Revenue Code of 1954, 26 U.S.C. 3402(k) or 3401, as amended and
21 applicable on January 1, 1983, received by persons for services rendered by them to patrons of premises
22 licensed to provide food, beverage, or lodging;

23 (g) all benefits received under the workers' compensation laws;

24 (h) all health insurance premiums paid by an employer for an employee if attributed as income to
25 the employee under federal law;

26 (i) all money received because of a settlement agreement or judgment in a lawsuit brought against
27 a manufacturer or distributor of "agent orange" for damages resulting from exposure to "agent orange";

28 (j) principal and income in a medical care savings account established in accordance with
29 15-61-201 or withdrawn from an account for eligible medical expenses, as defined in 15-61-102, of the
30 taxpayer or a dependent of the taxpayer or for the long-term care of the taxpayer or a dependent of the

1 taxpayer; and

2 ~~(k) principal and income in MONEY, NOT EXCEEDING \$3,000 FOR EACH TAXPAYER,~~
 3 ~~CONTRIBUTED TO a family education savings program account established in accordance with [section 4]~~
 4 ~~of;~~

5 (L) PRINCIPAL withdrawn from an account for qualified higher education expenses, as defined in
 6 [section 3], for a designated beneficiary of the taxpayer; and

7 ~~(k)(M)~~ the recovery during the tax year of any amount deducted in any prior tax year to the
 8 extent that the recovered amount did not reduce the taxpayer's Montana income tax in the year deducted.

9 (3) A shareholder of a DISC that is exempt from the corporation license tax under 15-31-102(1)(l)
 10 shall include in the shareholder's adjusted gross income the earnings and profits of the DISC in the same
 11 manner as provided by section 995 of the Internal Revenue Code, 26 U.S.C. 995, for all periods for which
 12 the DISC election is effective.

13 (4) A taxpayer who, in determining federal adjusted gross income, has reduced the taxpayer's
 14 business deductions by an amount for wages and salaries for which a federal tax credit was elected under
 15 ~~section 44B~~ sections 38 and 51(a) of the Internal Revenue Code of 1954, ~~as that section~~ those sections
 16 may be labeled or amended, is allowed to deduct the amount of the wages and salaries paid regardless of
 17 the credit taken. The deduction must be made in the year the wages and salaries were used to compute
 18 the credit. In the case of a partnership or small business corporation, the deduction must be made to
 19 determine the amount of income or loss of the partnership or small business corporation.

20 (5) Married taxpayers filing a joint federal return who are required to include part of their social
 21 security benefits or part of their tier 1 railroad retirement benefits in federal adjusted gross income may split
 22 the federal base used in calculation of federal taxable social security benefits or federal taxable tier 1
 23 railroad retirement benefits when they file separate Montana income tax returns. The federal base must be
 24 split equally on the Montana return.

25 (6) A taxpayer receiving retirement disability benefits who has not attained age 65 by the end of
 26 the tax year and who has retired as permanently and totally disabled may exclude from adjusted gross
 27 income up to \$100 per week received as wages or payments in lieu of wages for a period during which the
 28 employee is absent from work due to the disability. If the adjusted gross income before this exclusion and
 29 before application of the two-earner married couple deduction exceeds \$15,000, the excess reduces the
 30 exclusion by an equal amount. This limitation affects the amount of exclusion, but not the taxpayer's

1 eligibility for the exclusion. If eligible, married individuals shall apply the exclusion separately, but the
2 limitation for income exceeding \$15,000 is determined with respect to the spouses on their combined
3 adjusted gross income. For the purpose of this subsection, permanently and totally disabled means unable
4 to engage in any substantial gainful activity by reason of any medically determined physical or mental
5 impairment lasting or expected to last at least 12 months. (Subsection (2)(f) terminates on occurrence of
6 contingency--sec. 3, Ch. 634, L. 1983.)"

7

8 **NEW SECTION.** **Section 13. Implementation of staggered terms.** (1) To implement the
9 staggered-term system provided for in [section 6], the first terms of the members are as follows:

10 (a) one member shall serve a 1-year term;

11 (b) two members shall serve 2-year terms;

12 (c) two members shall serve 3-year terms; and

13 (d) two members shall serve 4-year terms.

14 (2) Upon expiration of the terms provided for in subsection (1), each member shall serve a 4-year
15 term.

16

17 **NEW SECTION.** **Section 14. Codification instruction.** (1) [Sections 1 through 5 and 8 through 11]
18 are intended to be codified as an integral part of Title 15, and the provisions of Title 15 apply to [sections
19 1 through 5 and 8 through 11].

20 (2) [Sections 6 and 7] are intended to be codified as an integral part of Title 20, chapter 25, and
21 the provisions of Title 20, chapter 25, apply to [sections 6 and 7].

22

23 **NEW SECTION.** **Section 15. Effective date.** [This act] is effective July 1, 1997.

24

-END-