

MAINE STATE LEGISLATURE

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FIRST REGULAR SESSION

ONE HUNDRED AND NINTH LEGISLATURE

Legislative Document

No. 1421

S. P. 461

In Senate, March 23, 1979

Referred to the Committee on Taxation. Sent down for concurrence and ordered printed.

Presented by Senator Najarian of Cumberland.

MAY M. ROSS, Secretary of the Senate

STATE OF MAINE

IN THE YEAR OF OUR LORD NINETEEN HUNDRED
SEVENTY-NINE

**AN ACT to Establish a Higher Education Tax Deferred Savings Plan and Other
Tax Benefits for Parents and Students.**

Be it enacted by the People of the State of Maine, as follows:

Sec. 1. 36 MRSA § 5122, sub-§ 1, ¶ C is enacted to read:

C. Recaptured income related to a qualified higher education fund, determined as follows.

(1) Upon termination of a qualified higher education fund under subsection 5, paragraph E, subparagraph (3), divisions (a), (b), or (e), a taxpayer to whom the assets of the fund are required to be distributed shall add to his federal adjusted gross income for the taxable year during which the terminating event occurs an amount equal to 110% of the value of the assets of the fund immediately prior to termination. Upon termination of a qualified higher education fund under subsection 5, paragraph E, subparagraph (3), divisions (c) or (d), a taxpayer to whom the assets of the fund are required to be distributed shall add to his federal adjusted gross income for the taxable year during which the terminating event occurs an amount equal to 100% of the value of the assets of the fund immediately prior to termination. For purposes of this paragraph, the value of the assets of the fund immediately prior to termination shall include the value of any distributions made to or on

behalf of an eligible beneficiary who subsequently ceased to be an eligible beneficiary pursuant to subsection 5, paragraph A.

(2) Payments made to or on behalf of an eligible beneficiary from a qualified higher education fund shall be added to the federal adjusted gross income of the individual taxpayer to whom or on whose behalf the payment is made, in accordance with the following. For the first taxable year of such taxpayer in which no payment described in the first sentence of this subparagraph is made with respect to him and during which he is not a student or engaged in volunteer service of no longer than 4 years duration, 1/5 of the aggregate of all such payments previously made shall be added to the federal adjusted gross income of the taxpayer for that taxable year and for each of the first 4 succeeding taxable years in which no such payment is made and in which the taxpayer is not a student or engaged in volunteer service of no longer than 4 years duration. If, in a taxable year subsequent to a taxable year in which such addition to federal adjusted gross income is required, a payment described in the first sentence of this subparagraph is made, 1/5 of the amount of the payment shall be added to the federal adjusted gross income of the taxpayer for each of the 5 immediately succeeding taxable years in which no such payment is made and in which the taxpayer is not a student or engaged in volunteer service of no longer than 4 years duration.

Sec. 2. 36 MRSA § 5122, sub-§ 2, ¶¶ C and D are enacted to read:

C. Contributions to a qualified higher education fund.

(1) A taxpayer may subtract from his federal adjusted gross income amounts which during the taxable year are contributed by him to a qualified higher education fund established by him, limited to the product of \$1,000 and the largest number of his eligible beneficiaries during the taxable year. For this purpose, the number of eligible beneficiaries shall not include any individual who was a student at an institution of higher education during the previous taxable year.

(2) A taxpayer who establishes a qualified higher education fund may subtract from his federal adjusted gross income amounts included in gross income for federal income tax purposes by reason of any income realized by the fund or because of any payment by the fund to, or on behalf of, an eligible beneficiary.

D. The amount of tuition paid during the taxable year on behalf of each dependent or person who is eligible to be an eligible beneficiary for at least half-time attendance at an institution of higher education, which amount shall not exceed ½ of such tuition or \$1,000, whichever is less. This paragraph shall not apply if the tuition is paid from a qualified higher education fund.

Sec. 3. 36 MRSA § 5122, sub-§ 5 is enacted to read:

5. Definitions. For the purposes of this section, unless the context otherwise indicates, the following terms shall have the following meanings.

A. "Eligible beneficiary" means a person who is the creator of the fund or who has any of the following relationships to the creator: Dependent; spouse; son or daughter, or stepson or stepdaughter, or descendent of any son, daughter, stepson or stepdaughter; brother, sister, stepbrother or stepsister; or son or daughter of a brother, sister, stepbrother or stepsister.

A person who meets the requirements of this paragraph shall cease to be an eligible beneficiary:

(1) If payments by the fund to him or on his behalf do not commence within 5 years after the date on which that person was graduated or separated from secondary school, excluding any period of up to 4 years in volunteer service;

(2) After the expiration of 10 years from the date of such graduation or separation, excluding any period of up to 4 years in volunteer service; or

(3) If within one year after his 18th birthday he does not file with the State Tax Assessor, on a form in the manner prescribed by rule, a notice of consent relating to the tax treatment of payments from a qualified higher education fund. The termination provisions of this paragraph shall not apply to a qualified higher education fund established for the benefit of the creator or the spouse of the creator, in which cases the fund shall terminate after the expiration of 15 years from the commencement date of the fund.

B. "Institution of higher education" means an educational organization:

(1) Which normally maintains a regular faculty and curriculum and normally has a regularly enrolled body of pupils or students in attendance at the place where its educational activities are regularly carried on;

(2) Which provides an educational program for which it awards an associate, baccalaureate or higher degree or provides a program which is acceptable for full credit towards such a degree or which is a vocational, technical or career school;

(3) Which is legally authorized to provide and does provide a program of post-secondary education; and

(4) Which is accredited by a nationally recognized accrediting agency or association listed by the United States Commissioner of Education.

C. "Student" means an individual who attends an institution of higher education on at least a half-time basis.

D. "Volunteer service" means service in the Armed Forces of the United States on active duty or in the Peace Corps, or full-time volunteer service under the Domestic Volunteer Service Act of 1973.

E. "Qualified higher education fund" is a fund which meets the following requirements.

(1) The fund shall be created pursuant to a written plan established:

(a) Solely for the purpose of defraying costs associated with attendance subsequent to graduation or separation from secondary school at an institution of higher education of one or more eligible beneficiaries, such costs to include applicable tuition and fees, exclusive of fees levied as a penalty for laboratory breakage, dormitory damage and similar fees, room and board as charged by the institution pursuant to a contract entered into by the institution pursuant to a contract entered into by the institution and a student or, if no such contract is entered into, an amount not exceeding \$1,500 per year, which amount shall include any expenses of transportation, and books, supplies and equipment;

(b) Which provides that no distribution shall be made by the fund, except upon termination thereof, other than to, or on behalf of, eligible beneficiaries;

(c) Which provides that, upon termination of the fund, all assets of the fund shall be distributed to the creator of the fund, to his estate or to a trust established for the purpose of making contributions to the fund; and

(d) Which prohibits contributions to the fund in excess of amounts which may be subtracted from federal adjusted gross income under subsection 2, paragraphs C and D.

(2) The fund shall:

(a) Constitute a custodial account, the assets of which are held by a bank, as defined in the Internal Revenue Code, section 401 (d) (1), an insurance company qualified to do business in this State, or another person who demonstrates, to the satisfaction of the State Tax Assessor, that the manner in which he will hold the assets will be consistent with the requirements of this subsection; or

(b) Be a trust.

In the case of a trust, the assets may be held by a bank or other person who demonstrates to the satisfaction of the State Tax Assessor that the manner in which he will administer the trust will be consistent with the requirements of this subparagraph. Such a trust shall not be disqualified under this division merely because a person other than the trustee so administering the trust may be granted, under the trust instrument, the power to control the investment of the trust funds either by directing investments, including reinvestments, disposals and exchanges, or by disapproving proposed investments, including reinvestments, disposals and exchanges. Such a trust may use annuity, endowment or life insurance contracts of a life insurance company exclusively as the funding media of the trust, if so provided by rule of the State Tax Assessor and if the life insurance company supplies annually such information about trust transactions as the State Tax Assessor shall by rule prescribe.

(3) An otherwise qualified higher education fund shall terminate:

- (a) If a contribution is made to the fund in excess of the amount allowable as a subtraction from federal adjusted gross income under subsection 2, paragraphs C and D;**
- (b) If a distribution is made by the fund other than to, or on behalf of, an eligible beneficiary for the purpose specified in subparagraph (1);**
- (c) If the plan ceases to have an eligible beneficiary;**
- (d) In the absence of a testamentary disposition or inter vivos trust provision to the contrary, upon the death of the creator of the fund; or**
- (e) If any contribution is made to the fund by its creator during a taxable year with respect to which he is a nonresident individual or by a nonresident trust or estate.**

Sec. 4. Effective date. This Act shall take effect for any taxable year beginning after December 31, 1978.

STATEMENT OF FACT

The purpose of this bill is to assist persons who wish to pay educational costs for themselves and spouses, children and other relatives. For tax years beginning after December 31, 1978, Maine residents may claim education deductions from adjusted gross income on a Maine personal income tax return by 2 methods.

The first method permits a deduction for a portion of the tuition expenses paid for sending dependents, including self and spouse, children and other relatives to college or other institutions of higher education. A taxpayer may deduct for each dependent up to $\frac{1}{2}$ of the amounts paid for tuition or \$1,000, whichever is less.

The 2nd method permits a deduction for contributions to a qualified higher education fund established solely for the purpose of defraying the future costs of higher education for eligible beneficiaries. Later, when the beneficiaries finish college, they report the distributions received, i.e., from the contribution made and earnings received, from the fund as ordinary income, over a 5-year period. Deductions may be taken for contributions to a qualified higher education fund for up to \$1,000 for each eligible beneficiary.

A taxpayer may claim one or both deductions, thereby providing assistance both to taxpayers assisting persons now in eligible schools and to taxpayers saving for the future education of eligible beneficiaries. Since both deductions are subtracted from federal adjusted gross income in computing adjusted gross income for Maine tax purposes, a person may claim the deduction whether or not he itemizes deductions. The deductions are made only in the taxable year in which the tuition expenses are paid or contributions made to the fund. Nonresident taxpayers may not claim the deduction.